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ABSTRACT

This project developed four lessons that reflect the 1981 tax laws as they relate to the use of investment credit and depreciation in farm accounting systems. Project staff reviewed tax laws and related materials and identified four lessons in farm management and supervised occupational experience that needed revision. Materials were then organized and appropriate lesson plans were developed for use in the vocational agriculture program. The lesson plans, part of existing Missouri vocational agriculture curriculum, cover farm records, managing taxes to maximize income, using depreciation/cost recovery and investment credit in a farm business, and setting up depreciation/cost recovery schedules and inventories. Each lesson contains an objective, study questions, references, handouts, teaching procedures, information sheets, sample forms, exams, and exam answers. (KC)

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FINAL REPORT

# REVISING THE DEPRECIATION AND INVESTMENT CREDIT LESSONS FOR FARM MANAGEMENT AND SUPERVISED OCCUPATIONAL EXPERIENCE FOR USE IN MISSOURI PROGRAMS OF VOCATIONAL AGRICULTURE

Project No. 84-131/132-600-2 (116-116)(C)

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ABSTRACT

REVISING THE DEPRECIATION AND INVESTMENT CREDIT LESSONS
FOR FARM MANAGEMENT AND SUPERVISED OCCUPATIONAL
EXPERIENCE FOR USE IN MISSOURI PROGRAMS OF
VOCATIONAL AGRICULTURE

The project provided for a review of tax laws and related materials as well as four lessons in Farm Management and Supervised Occupational Experience to identify the concepts to be taught in these units. Materials were then organized and appropriate lesson plans were developed for use in the instructional program in vocational agriculture in Missouri. The revised lessons are available for distribution and this availability has been called to the attention of Missouri teachers.

REVISING THE DEPRECIATION AND INVESTMENT CREDIT LESSONS
FOR FARM MANAGEMENT AND SUPERVISED OCCUPATIONAL
EXPERIENCE FOR USE IN MISSOURI PROGRAMS
OF VOCATIONAL AGRICULTURE

## Statement of the Problem

Instructional guides in Farm Management and Supervised Occupational Experience have been prepared and are available from the Instructional Materials Lab at the University of Missouri-Columbia. These guides contain lessons about the calculation and use of depreciation and investment credit in farm accounting and record keeping. The materials prepared prior to this project did not reflect major changes in the provisions of the tax laws in 1981. Therefore, the instructional materials were out-of-date and, in fact, their use would result in the teaching of incorrect information. The revising of these lessons was listed as the top priority for curriculum development in agriculture by the Teaching Aids Committee of 13 teachers at their January 28, 1983 meeting. Therefore, the problem addressed by this project was the development of four lessons for use in programs of vocational agriculture which reflect the 1981 tax laws as they relate to the use of investment credit and depreciation in farm accounting systems.

## Objectives

I. A. The first objective was to review changes in the 1981 tax laws relating to depreciation and investment credit and to identify those concepts which should be taught in programs of vocational agriculture.

B. Copies of the 1981 tax laws and related materials including those prepared by tax specialists in Agricultural Economics Extension at the University of Missouri-Columbia were reviewed. Appropriate concepts and the needed materials for teaching were identified. Appropriate subject matter specialists were also consulted.

II. A. The second objective was to develop appropriate lesson plans to replace those in Farm Management and Supervised Occupational Experience that include teacher guides, transparency masters, and student handouts in the area of depreciation and investment credit which reflect the 1981 changes in the tax laws.

B. The four existing lessons in the Farm Management and the Supervised Occupational Experience units were identified for revision. Revised lesson plans were developed for these lessons. The plan included an assignment sheet with study questions, suggested teaching procedures including a content outline, transparency masters, student handouts, and an evaluation sheet with answers. The completed lessons were reviewed by subject matter specialists and teachers for content accuracy and instructional appropriateness.

III. A. The third objective was to provide a copy of the revised materials to each supervisor and teacher educator in Agricultural Education in Missouri and to make the materials available through the Instructional Materials Laboratory, University of Missouri-Columbia, for sale to use in programs of vocational agriculture and to provide five copies of the materials to the Research Coordinating Unit.

B. The lessons were typed in final format compatable with the existing materials and made available to the appropriate groups.

Population and Sample

The project involved the review of specific materials and did not deal with a group in developing the materials. However, the materials developed are to be available to all teachers of vocational agriculture in Missouri.

Conclusions and Recommendations

Four lessons were revised, two for units in Farm Management and two for

units in Supervised Occupational Experience Programs. The revised lessons reflect the 1981 tax laws as they relate to using depreciation and investment credit in farm accounting. It is recommended that all teachers of vocational agriculture in Missouri obtain and use the revised lessons in their programs.

Disclaimer

The statement below is to be shown on all documents or reports which are a result of the project.

> "The activity which is the subject of this report was supported in whole or in part by funds from the Department of Elementary and Secondary Education, Division of Career and Adult Education. However, the opinions expressed herein do not necessarily reflect the position or policies of the Missouri Department of Elementary and Secondary Education or the Division of Career and Adult Education, and no official endorsement should be inferred."

Attachments

The project procedures are outlined with the objectives. References for objectives one and two were as follows:

Denker, Robert. Agricultural Management and Economics Instructor's Guide. Columbia, Missouri: Instructional Materials Laboratory, 1976.

Denker, Robert. Supervised Occupational Experience Program Instructor's Guide. Columbia, Missouri: Instructional Materials Laboratory, 1977.

Department of Revenue. Farmer's Tax Guide - 1983. Washington, D.C.: Government Printing Office, 1983.

_____. US Master Tax Guide - 1982. 65th ed. Chicago: Commerce Clearing House, Inc., 1981.

The bibliography list is the same as the reference list and an instrument and glossary were not used.

Copy of Final Product

Copies of the four revised lessons are attached.

UNIT III - BUSINESS MANAGEMENT 15 days

Lesson 1 - Farm Records

Objective: At the conclusion of the lesson, students will be able to keep records in the Young and Adult Farmer Record Book including planning cash flows and summarizing the year's business.

Study Questions:

1. Why do we keep records?
2. What record systems are available?
3. What kinds of records should I keep?
4. What are some terms in record keeping and analysis?
5. How are entries recorded in the book?

References:

1. *Missouri Young and Adult Farmer Record Book* - IML
2. *Missouri Young and Adult Farmer Record Book Transparencies* - IML
3. *Missouri Young and Adult Farmer Record Book Sample Entries* - IML
4. Transparencies
   a. TM-III-1: Why Keep Records
   b. TM-III-2: Analysis of Capital Investments - Form A Computation of Enterprise Facilities
   c. TM-III-3: Analysis of Capital Investments - Form B Enterprise Profitability Analysis
   d. TM-III-4: Analysis of Capital Investments - Form C Enterprise Cash Flow Analysis

4. Handouts

   a. HO-III-1: Using the Farm Business Analysis Record Book

   b. HO-III-2: Sample Entries for Whole Farm Cash Flow Problem

   c. HO-III-3: Sample Problem for Enterprise Cash Flow

   d. HO-III-4: Analysis of Capital Investments - Form A Computation of Enterprise Facilities

   e. HO-III-5: Analysis of Capital Investments - Form B Enterprise Profitability Analysis

   f. HO-III-6: Analysis of Capital Investments - Form C Enterprise Cash Flow Analysis

UNIT III - BUSINESS MANAGEMENT

TEACHING PROCEDURE

A. Review of previous lesson (if applicable)

B. Motivation: Ask students what type of records are kept at home. What problems pertaining to records do they notice at home? Can you imagine a farmer making a profit on one enterprise and losing on another? What about making a profit raising corn and losing some of that profit feeding it to cattle? We need to study records - develop a system that is simple and time saving, but still gives us the information we need.

C. Make assignment - distribute copies of the handouts

D. Have a study period

E. Refer to "Tabs" of record book

F. Discussion:

1. Discuss question #1 using TM-III-1 - Why Keep Records - as a guide.

    a. Why do we keep records?
        1) External reasons
            a) Correct and defensible income tax reporting
            b) Tax management
            c) Self-employment social security taxes
            d) Social security taxes on hired labor
            e) Good credit relations
            f) Sound credit planning
            g) Business continuity
            h) Landlord-tenant relationships
        2) Internal reasons
            a) Identify strong and weak points of business
            b) Planning business changes
            c) Operation and control of the business

2. Discuss question #2. Have samples of the different systems available if possible. Point out that we'll be using the *Missouri Young and Adult Farmer Record Book* since it is designed for our specific purpose. They may select a different system later if it suits their needs better.

a. What record systems are available?
   1) Missouri Young and Adult Farmer Record Book
   2) Missouri Looseleaf Record Book
   3) Missouri Mail-In Record System
   4) PCA Mail-In Record System
   5) Farm Bureau Mail-In Record System
   6) Various books sponsored by banks, feed companies, etc.
   7) Cancelled checks, deposit slips, etc.

3. Discuss question #3 by listing kinds of records on board referring to it in the *Missouri Young and Adult Farmer Record Book*. Be sure to see the purpose of each form - use examples. The *Missouri Young and Adult Farmer Record Book Sample Entries* contains examples for form use. This may be the end of the day's activities.

   a. What kinds of records should I keep?
      1) Cash income
      2) Cash expenditures
      3) Inventories
      4) Depreciation
      5) Family Living
      6) Enterprise
      7) Cash flow - planned and actual
      8) Profit and loss statement
      9) Net worth statement

4. Discuss question #4. List the terms on the board - give an example - find out where it is used in the *Missouri Young and Adult Farmer Record Book*. Examples are in the *Missouri Young and Adult Farmer Record Book Sample Entries* and in Lesson 2 on analysis.

   a. What are some terms in record keeping and analysis?
      1) Expenses - cash leaving the business
      2) Receipts - cash coming into the business
      3) Assets - things owned
      4) Liabilities - things owed
      5) Net worth - assets minus liabilities
      6) Asset:Liability ratio - assets ÷ liabilities
      7) Current ratio - current assets ÷ current liabilities
      8) Inventory - list of items owned including quantity and value
      9) Principal - unpaid balance of a loan
      10) Basis - current book value of an asset
      11) Capital items - items used in production
      12) Operating items - items consumed as feed, fertilizer, etc.

13) Depreciation - the amount a capital item decreases in value

14) Investment credit - an income tax term which is a direct credit against taxes

5. Secure a transparency of each form in the *Missouri Young and Adult Farmer Record Book*. Provide a copy of the sample list of entries in this lesson for each student. Let students work in their books as the instructor works the problem on the overhead projector. Or, to avoid using the actual book, the forms are available in pad form from IML. Some teachers prefer to have students complete only two months of expenses and receipts and then the total for the year. It may take too much time to complete an entire book.

6. Generally, the goal at this point should be to acquaint the students with how to make expense and receipt entries, to set up inventories, depreciation schedules and cash flow. Records should be made simple and easy to understand so students will enjoy their work.

Other Suggestions:

a. Students should be permitted to keep their own SOE farming records in the Young Farmer Record Book. Setting up their inventories, cash flow budget and current expenses and receipts would be the next step. Frequently, students will want to set up a record system for their parents in a separate book and help them get started on an improved record keeping system.

b. Teachers should schedule at least one period per month to help students keep their own and/or their parents' records up-to-date.

c. If there is time, a cash flow for a new or expanded enterprise could be worked. Sample set of forms and a problem is also attached.

G. Summarize by letting students review their plans for using the *Missouri Young and Adult Farmer Record Book*

H. Quiz and/or evaluation

# WHY KEEP RECORDS?

1. External Reasons

   A. CORRECT AND DEFENSIBLE INCOME TAX REPORTING
   B. TAX MANAGEMENT
   C. SELF-EMPLOYMENT SOCIAL SECURITY TAXES
   D. HIRED LABOR TAXES
   E. GOOD CREDIT RELATIONS
   F. SOUND CREDIT PLANNING
   G. BUSINESS CONTINUITY
   H. LANDLORD-TENANT RELATIONS

2. Internal Reasons

   A. IDENTIFY STRONG AND WEAK POINTS OF BUSINESS
   B. PLANNING BUSINESS CHANGES
   C. OPERATION AND CONTROL OF THE BUSINESS

UNIT III - BUSINESS MANAGEMENT

# USING THE FARM BUSINESS ANALYSIS RECORD BOOK

## Introduction

Farmers are becoming "traffic managers' of a two way flow of dollars. They are relying more on purchased inputs, increasing the size of business, operating on smaller margins, and adapting to the situation where management skills are most important. A study of farmers enrolled in the UMC Mail-In Record Program from 1969-73 showed that on an average, they managed over $400,000 capital and had sales of over $120,000 in 1973. Capital increased 342% in the last 10 years. More complete management information is needed by farmers.

## Purposes of Farm Records

Farm records are kept for many purposes as outlined below. Selection of purposes to fit your needs will determine which records should be kept.

1. *External reasons* - these are reasons that affect decisions as a result of relations with others and include the following:

   a. *Correct and defensible income tax reporting.* IRS income tax reports and audits are "painful" in proportion to the lack of adequate records.

   b. *Tax management.* Adequate and accurate records are needed to determine the tax due, but to avoid overpayments. Good records will also assist in planning year-end management techniques to level income and gain some larger tax savings.

   c. *Self-employment social security taxes.* Since these are paid on only certain farm income, a good set of records is necessary.

   d. *Social security taxes on hired labor.* This has become an important factor since many farmers will have employees that meet the minimum requirement.

   e. *Good credit relations.* As credit usage has increased, lenders are placing more emphasis on good records.

f. *Sound credit planning.* Farmers need adequate records to plan future credit needs and to provide adequate protection for their business.

g. *Business continuity.* Death, injury, disease or other causes can force a spouse or child to suddenly assume responsibility for a farm business. Details of credit, taxes, cost basis of real estate, etc., are all needed at this time.

h. *Landlord-tenant relationship.* End-of-year settlements of shared costs and income require that adequate records were kept.

2. *Internal reasons* - these are probably the most important since the basic reason for the farm business is to make a profit. Some of the internal reasons for keeping records are:

a. *Identify strong and weak parts of the business.* Good records will help answer questions such as: Is the business too small? Which enterprise should I expand? Which should be eliminated? Are my costs under control? Is my production too low?

b. *Planning business changes.* Budgeting, estimating income or expenses, planning changes in the farm business will be much more accurate if the individual farm data is used.

c. *Operation and control of the business.* The prior year's records can set standards to compare this year's operation against. If it is falling behind, corrective steps can be taken before it is disastrous.

## Kinds of Record Systems

There are numerous record systems available. A system should be selected (from the list below) that will provide the information desired with the least effort and expense. Frequently, a system requiring little effort will not return the desired information. Some of the systems available in Missouri include the following:

1. Missouri Young Farmer Record Book. Available through local Vocational Agricultural departments or by writing Instructional Materials Laboratory, 10 Industrial Education Building, University of Missouri-Columbia, Columbia, Missouri 65201.

2. Missouri Looseleaf Record Book. Available through local extension offices.

3. Missouri Mail-In Record System. A computer-based record system available by contacting the local extension office.

4. Production Credit Mail-In Record System. A computer-based record system available through local PCA offices.

5. Farm Bureau Mail-In Record System. A computer-based record system available through local Farm Bureau offices.

6. Various record books sponsored by banks, feed companies, etc.

7. Cancelled checks, deposit slips, etc., could also be considered a record system.

Since most Vocational Agricultural departments will be using the *Missouri Young and Adult Farmer Record Book*, the rest of the discussion will deal with that record book. Also, since over 97% of the farmers report income tax on the cash basis, examples, etc., will be in reference to the cash basis.

## Kinds of Records to Keep

A farmer will need to decide his purposes for keeping records and then keep those that will enable him to reach his objectives. Farmers that select most of the external and internal reasons listed earlier will keep the following records:

1. *Cash income or receipts.* This would be a record of all cash coming into the farm business. It would include cash received from the sale of grain, livestock, custom work, breeding stock, etc. Money borrowed would also be recorded since it is coming into the business. These cash items are separated into different columns because of tax treatment and for analysis of the business.

2. *Cash expenses.* All cash paid out including that for capital items (as machinery, breeding livestock) and payments on principal or interest would be included. The same principle applies as to dividing into columns.

3. *Inventories.* A record of all property owned plus its quantity and value, usually at the start of the year, is kept also for tax purposes and to use in analysis.

4. *Depreciation records.* These are needed to arrive at current or "book values." Depreciation is a deductible expense for income tax and must be considered in the analysis of the farm business.

5. *Family living records.* These are not necessary for the farm business, but often are desired by the family and may be useful in itemizing income tax deductions.

6. *Enterprise accounts.* By recording all income and expense items that are directly related to a specific enterprise (other than overhead items) on the enterprise pages, an analysis will be more meaningful and accurate.

7. *Cash flow.* Budget and summary. This provides a place to summarize the cash records and is needed for both tax and analysis purposes. As a budget, an estimated cash flow is a valuable tool in planning the year's business.

8. *Profit and loss statement.* This form brings together the year's business and provides a summary for the total farm business. It includes the cash expenses and receipts and a place for inventory adjustments. It is used primarily in business analysis.

9. *Net worth statement.* (Frequently called a Financial Statement.) This is a record of an individual's or business's assets (things he owns) and liabilities (owed items). It is needed to measure financial growth and, also, frequently needed when obtaining credit.

## Some Terms Used in Farm Records

In order to be sure we can understand each other, it is probably necessary to define some terms used in keeping farm records. An understanding of these will also be helpful in income tax work and in the analysis of a farm business.

1. *Expenses* - usually is cash leaving the farm business. Another term that is used frequently is "disbursements."

2. *Receipts* - usually is cash coming into the farm business. The term "income" implies the same thing.

3. *Assets* - this term is used in a net worth statement and is everything that is owned. Current assets are those assets which will be in the form of cash within one (1) year. Feed, cash in the bank, fattening cattle, are examples of usual current assets. Intermediate assets are those which have a life of two to five (2-5) years. Breeding livestock, machinery, etc., are usually in this group. Long term assets usually have a life of over five (5) years. Land, buildings, etc., are usually in this group.

4. *Liabilities* - this term is also used in a net worth statement and is the opposite of assets. Liabilities are the amounts "owed." Current liabilities are those items due within a year. Short-term notes, feed bills, and the amount of a long-term note due within a year are examples of short-term liabilities. Intermediate liabilities are notes and bills due within two to five (2-5) years. Examples would be notes on machinery, etc., that are due later than this year. Long-term liabilities are items due over a longer peiod of time, usually over five (5) years. Loans on real estate, most buildings, etc., are of this nature.

5. *Net worth* - is the difference between assets and liabilities. It is the amount an individual would have in cash if he sold everything and paid all his bills and debts.

6. *Asset:Liability ratio* - relationship between total assets and total liabilities. If a farmer has total assets of $120,000 and liabilities of $60,000; he is said to have an asset:liability ratio of 2:1. Another way of expressing the same thing is that this farmer's liability:asset ratio is 50%. Or, he has a liability:net worth of 1:1.

7. *Current asset:Liability ratio* - a ratio as in number 6; but this uses only current assets and current liabilities. It is a measure of his liquidity.

8. *Inventory* - a record showing what is owned, including quantity and value. Specific instructions for valuing different inventory items are in the Young Farmer Record Book.

9. *Principal* - usually the unpaid balance owed on a loan.

10. *Basis* - might be considered "book value" of an item. As an example, if a machine is purchased for $1,000 and then depreciated $600, it has a basis of $400. If it is traded on a new machine and $800 "boot" paid; the basis of the new machine is $1,200.

11. *Capital items* - usually items with a life of over one year which are used to produce something. A breeding cow, tractor, land, etc., would be capital items. A feeder pig would not be a capital item.

12. *Operating items* - usually a cost or return involved in production and recovered within a year. As examples; feed, fertilizer and fuel, would be operating items.

13. *Depreciation/cost recovery* - the amount a capital item decreases in value. It is usually deducted as an expense. Depreciation may occur as a result of wear, tear, or just because it become out-of-date. The method used under the Economic Recovery Tax Act of 1981 is referred to as ACRS (Acclerated Cost Recovery System) and gives the farmer a choice between an accelerated method and an alternate straight line method for recovery of costs. Under the new law, an item is recovered for its complete value and no salvage value is ever claimed. The Farmer's Tax Guide explains each of these. Refer also to Lesson 8.

14. *Investment credit* - a term used in income tax reporting. Beginning in 1983, the rate of investment credit which could be claimed on 3- and 5-year property could vary based upon the tax needs of the individual. Refer to Lesson 9. It is simply a percentage rate which provides a direct tax credit, dollar for dollar, for qualifying items.

15. *Liquidity* - refers to the ability to meet current obligations. It is usually expressed in the current asset: current liability ratio. A farmer with good liquidity would have enough cash on hand and other current assets to meet his bills as they come due.

16. *Solvency* - refers to total asset:total liability ratio and is a measure of the financial strength (ability to withstand business reverses) of an individual or business.

## Instructions for the Young Farmer Record Book

It is suggested that you refer to the "tabs" in the record book for instructions on recording entries in the book. The publications *Missouri Young and Adult Farmer Record Book Sample Entries* and *Missouri Young and Adult Farmer Record Book Instructor's Guide* provide practice in making these entries.

Credit: Part of this handout was adapted from Extension Farm Management Publication FM 6940.

UNIT III - BUSINESS MANAGEMENT

SAMPLE ENTRIES FOR WHOLE FARM CASH FLOW PROBLEM
(for use with Form 27 in Record Book)

Money Going Out

Has $4,500 operating money borrowed first of year.

1. Cost $400/month family living plus extra $1,000 in March for taxes and $500 in December.
2. Has payment to Insurance Company in July and December of $4,000 for principal and interest on real estate loan.
3. Has payment of $400/month to FHA on loans.
4. Plans to buy new corn planter in March for $1,200 difference.
5. Plans to buy a bull in June for $750.
6. Operating expenses - estimated
   a. Fertilizer - $1,800 in February; $2,600 in April
   b. Chemicals - $700 in April
   c. Seed - $200 in March; $500 in April
   d. Machinery Repair - $50/month plus extra $500 in May and July
   e. Machine Hire - $1,000 in November
   f. Building and Fence Repair - $50/month plus $2,500 in March
   g. Feed - $600/month
   h. Vet - $10/month
   i. Fuel - $200 in March, May, June and September
   j. Truck - $40/month
   k. Labor - $400 in June
   l. Utilities - $40/month
   m. Taxes - $1,100 in December
   n. Insurance - $100 in April, July, September and December
   o. Misc. - $100/month

7. Clear 20 acres in September - $2,000.

8. Interest of $1,100 in December.

Money Coming In

| | | |
|---|---|---|
| Sell 50 steers in October - 1,000# @ 40 | = | $20,000.00 |
| Sell 40 heifers in August - 900# @ 39 | = | 14,040.00 |
| Plans to sell 8 cull cows in November - 900# @ 27 | = | 1,944.00 |
| Sell 100 hogs in February - 225# @ 30 | = | 6,750.00 |
| Sell 100 hogs in March - 225# @ 30 | = | 6,750.00 |
| Sell 100 hogs in August - 225# @ 26 | = | 5,850.00 |
| Sell 100 hogs in September - 225# @ 26 | = | 5,850.00 |
| Sell 100 bu. beans in April @ $4.00 | = | 4,000.00 |
| Custom Combining - July | = | 1,000.00 |
| Custom Combining - November | = | 1,500.00 |
| Government payment - July | = | 2,000.00 |
| Wife receives $250/month | | |

# SAMPLE PROBLEM FOR ENTERPRISE CASH FLOW
(for use with HO-III-4 forms)

A man wants to build a 500 head hog finishing floor. He estimates that it will cost:

1. Land - 2 acres @ $300
2. Building - $15,000 - 20 year life
3. Feeders and Equipment - $5,000 - 10 year life

He estimates he can turn three (3) bunches per year and expects $5/head income over variable costs.

FORM A. ANALYSIS OF CAPITAL INVESTMENTS

BM-23
HO-III-4
TM-III-2

COMPUTATION OF ENTERPRISE FACILITIES

A. Description of Investment: _____

_____

_____

_____;

B. Investment Allocation and Annual Fixed Costs:

| Item (1) | Total Investment: No. of Units (2) | Total Investment: Cost per Unit (3) | Total Investment: Total Cost (4) | Annual Fixed Costs*: % Total Cost (5) | Annual Fixed Costs*: Annual Amount (6) |
|---|---|---|---|---|---|
| 1. Land (___ac. x $___) | | $ | $ | | $ |
| 2. Buildings, fences, etc: | | $ | $ | | $ |
| a. Subtotals | | | $ | | $ |
| 3. Machinery and equipment: | | $ | $ | | $ |
| a. Subtotals | | | $ | | $ |
| 4. TOTALS (L. 1, 2a, 3a) | | | $ | | $ |

* Annual fixed cost would include depreciation, interest, insurance, taxes, and repairs.

TB:ARH:5/72

FORM B. ANALYSIS OF CAPITAL INVESTMENT

ENTERPRISE PROFITABILITY ANALYSIS

Income over variable costs from enterprise (no. units x L. 15 appropriate block Planning Guide) ..... $ _____

Annual fixed costs of new facilities (Form A, L. 4, Col. 6) $ _____

Annual fixed costs of present facilities:

Bldgs., fences, $____value x ____% _____

Mach. & equip., $____value x ____% _____

Annual interest for livestock, feed, equipment (animal investment from block Planning Guide x ____% interest) _____

Annual labor (no. units x ____hrs.) (L. 16 or 17 appropriate block Planning Guide x ____rate per hour) _____

Total costs ..... $ _____

Net income from enterprise ..... $ _____

TB:ARH:5/72

FORM C. ANALYSIS OF CAPITAL INVESTMENT

## ENTERPRISE CASH FLOW ANALYSIS

Factual Data:

1. Total capital needed for facilities (Form A, L. 4, Col. 4) ..... $_____
2. Amount of capital to be borrowed ..... $_____
3. Interest rate on loan ..... _____%
4. Length of loan ..... _____yrs.
5. Annual principal payment facility loan $_____
6. Annual cash outlay for taxes, ins., repairs (_____%) ..... $_____
7. Amount of loan for breeding stock ..... $_____
8. Annual cash needed for L. 7 loan: Int. _____, principal _____..... $_____
9. Income over variable costs per unit ... $_____
10. Less, int, required for enterprise operating loan ..... $_____
11. Net income over variable costs ..... $_____

---

Cash Flow Analysis on Borrowed Funds:

| | Year of Loan | | | | | |
|---|---|---|---|---|---|---|
| | 19__ | 19__ | 19__ | 19__ | 19__ | 19__ |
| A. Added cash income: | | | | | | |
| 1. Income over variable costs ..... | | | | | | |
| 2. Cash from sale of old facilities ..... | | | | | | |
| 3. Total cash income ..... | | | | | | |
| B. Added cash outlay required for new investment: | | | | | | |
| 1. Cash payment on principal, facilities ..... | | | | | | |
| 2. Cash payment on principal, breeding livestock | | | | | | |
| 3. Interest required on unpaid balance, facil .. | | | | | | |
| 4. Interest required on unpaid balance, breeding livestock ..... | | | | | | |
| 5. Cash for taxes, ins., and upkeep ..... | | | | | | |
| 6. Other (added hired labor, etc.) ..... | | | | | | |
| 7. Total cash outlay ..... | | | | | | |
| C. Cash balance (+ or -) ..... | | | | | | |

BM-27
HO-III-6
TM-III-4

ARH:TB 5/72

Answers to Handout #4

COMPUTATION OF ENTERPRISE FACILITIES

BM-29

A. Description of Investment: Swine finishing floor
Capacity - 500 hd.

B. Investment Allocation and Annual Fixed Costs:

| Item (1) | Total Investment: No. of Units (2) | Total Investment: Cost per Unit (3) | Total Investment: Total Cost (4) | Annual Fixed Costs*: % Total Cost (5) | Annual Fixed Costs*: Annual Amount (6) |
|---|---|---|---|---|---|
| 1. Land (2 ac. x $300) | 2 | $ 300 | $ 600.00 | 8 | $ 48.00 |
| 2. Buildings, fences, etc: Shed (20 yr. life) | 1 | $15,000 | $ 15,000 | 12 | $ 1,800.00 |
| a. Subtotals | | | $ 15,000 | | $ 1,800.00 |
| 3. Machinery and equipment: Feeder Equip (10 yr. life) | 1 | $ 5,000 | $ 5,000 | 17 | $ 850.00 |
| a. Subtotals | | | $ 5,000 | | $ 850.00 |
| 4. TOTALS (L. 1, 2a, 3a) | | | $ 20,600 | | $ 2,695.00 |

* Annual fixed cost would include depreciation, interest, insurance, taxes, and repairs.

TB:ARH:5/72

Example Factor (10 yr. life) 10% + 4% + 3% = 17%

BM-30
Answers to HO-III-5

FORM B. ANALYSIS OF CAPITAL INVESTMENT

ENTERPRISE PROFITABILITY ANALYSIS

Income over variable costs from enterprise
(no. units x L. 15 appropriate block Planning Guide) ..... 1,500 x 1.00 = 1,500 hd. ..... $ 1,500

Annual fixed costs of new facilities
(Form A, L. 4, Col. 6) $ 2,675

Annual fixed costs of present facilities:

None Bldgs., fences, $___ value x ___% _____

Mach. & equip., $___ value x ___% _____

Annual interest for livestock, feed, equipment (animal investment from block Planning Guide x 8 % interest) 1,480
14 x 1500

Annual labor (no. units x .3 hrs.)
(L. 16 or 17 appropriate block Planning Guide x $2.00 rate per hour) 900
1,500 x .3 x 2.00

Total costs ..... $ 5,275

Net income from enterprise ..... $ 2,225

TB:ARH:5/72

FORM C. ANALYSIS OF CAPITAL INVESTMENT

## ENTERPRISE CASH FLOW ANALYSIS

Factual Data:

1. Total capital needed for facilities (Form A, L. 4, Col. 4) ..... $ 20,600
2. Amount of capital to be borrowed ..... $ 20,600
3. Interest rate on loan ..... 8 %
4. Length of loan ..... 7 yrs.
5. Annual principal payment facility loan $ 2,943
6. Annual cash outlay for taxes, ins., repairs ( 3 %) ..... $ 618
7. Amount of loan for breeding stock ..... $ 1,000
8. Annual cash needed for L. 7 loan: Int. 560, principal NONE ..... $ 560
   14 x 200 x .20
9. Income over variable costs per unit ... $ 5.00 (?)
10. Less, int, required for enterprise operating loan ..... $ 560
11. Net income over variable costs ..... $ 6,940

---

Cash Flow Analysis on Borrowed Funds:

| | Year of Loan | | | | | |
|---|---|---|---|---|---|---|
| | 19 72 | 19 73 | 19 74 | 19 75 | 19 76 | 19 77 |
| A. Added cash income: | | | | | | |
| 1. Income over variable costs ..... | 7,500 | 7,500 | 7,500 | 7,500 | 7,500 | 7,500 |
| 2. Cash from sale of old facilities ..... | | | | | | |
| 3. Total cash income ..... | 7,500 | 7,500 | 7,500 | 7,500 | 7,500 | 7,500 |
| B. Added cash outlay required for new investment: | | | | | | |
| 1. Cash payment on principal, facilities ..... | 2942.00 | 2942.00 | 2942.00 | 2942.00 | 2942.00 | 2942.00 |
| 2. Cash payment on principal, breeding livestock | — | — | — | — | — | — |
| 3. Interest required on unpaid balance, facil .. | 1648.00 | 1412.64 | 1178.20 | 941.76 | 706.00 | 471.20 |
| 4. Interest required on unpaid balance, breeding livestock ..... | 560.00 | 560.00 | 560.00 | 560.00 | 560.00 | 560.00 |
| 5. Cash for taxes, ins., and upkeep ..... | 618.00 | 618.00 | 618.00 | 618.00 | 618.00 | 618.00 |
| 6. Other (added hired labor, etc.) ..... | | | | | | |
| 7. Total cash outlay ..... | 5,768.00 | 5,532.64 | 5,298.20 | 5,061.76 | 4,826.56 | 4,591.20 |
| C. Cash balance (= or -) ..... + | 1,732.00 | 1,967.36 | 2,201.80 | 2,438.24 | 2,673.44 | 2,908.80 |

Answers to HO-III-6

BM-31

ARH:TB 5/72

UNIT III - BUSINESS MANAGEMENT

EXAM #1

1. Using the information provided below, complete the net worth statement for January 1, 1983. (Make copies of Net Worth Form 29 from Record Book to record answers.)

| | |
|---|---|
| Value of Machinery | $ 48,000. |
| Value of Land | 120,000. |
| Bank Checking Account | 2,000. |
| Stored Wheat | 9,000. |
| Steer Calves | 15,000. |
| Cow Herd | 10,000. |
| Value of Buildings | 4,000. |

Operating loan used to purchase calves due March 15 is $8,000.

20-year land loan balance is $50,000 with $5,000 due July 1.

2. A few brief facts about investment credit are as follows: Must be taken on all 3- and 5-year property. Can be taken on new or used property. When figuring basis on trade-ins, include remaining book value of trade-in for I.C. on new equipment, but not for used. On 5-year property, use 10% of qualified basis and reduce basis for cost recovery by ½ the I.C. taken--or--use 8%, and basis for cost recovery remains the same. On 3-year property, use 6% of qualified basis and reduce basis for cost recovery by ½ the I.C. taken--or--use 4%, and basis for cost recovery remains the same.

   Compute the investment credit on the following 5-year property for Farmer A who made the following purhcases: (NOTE: Keep basis for cost recovery at maximum.)

   a. Purchased a new $21,000 combine with designated life of five years.

   b. Traded a used tractor with an adjusted basis of $5,000 and, in addition, gave $6,000 extra for a new one with a life of seven years.

   c. Purchased a used baler for $500 cash and traded in an older baler with an adjusted basis of $300. The estimated life was set at seven years.

3. A farmer faces unusually high federal income taxes in To reduce the tax, he purchased a new tractor for $5,000 cash in September, 1983, and did not have a trade-in. The tractor was delivered in December, 1983. For 1983 he can:

   a. take regular depreciation for 1/4 of the year
   b. expense the complete $5000
   c. take advantage of investment credit
   d. do a, b and c

4. A farm net worth statement:

   a. is a required report for state income tax
   b. is used to determine farm income
   c. provides a financial picture of the farm business as of some particular date
   d. returns above all production costs

5. Long-term credit should be used to purchase:

   a. cattle
   b. machinery
   c. land and buildings
   d. fertilizer

6. A farmer bought a new tractor on January 2 for $8,000. What is the maximum depreciation which he can take the first year of ownership if it will last 8 years and then has no salvage value?

   a. $1,000
   b. $1,200
   c. $1,600
   d. $2,000

7. Bill Jones traded his old tractor on April 1, with an adjusted basis of $2,000, and $7,000 difference for a new one. He qualifies for investment credit of: (refer to problem 2 for rules on using investment credit).

   a. $600
   b. $700
   c. $467
   d. $900

# EXAM #2

1. Tax reports are more easily made out with the help of farm records. True or False

2. Farm records are helpful in recording financial growth. True or False

3. Farm records make farming more interesting. True or False

4. Farm records aid a farmer in trying to obtain credit. True or False

5. Farmers who keep good records usually make (more or less) profit.

6. Four of the six "types" of records a farmer should keep are:

   a.

   b.

   c.

   d.

7. One "good" record keeping system that we worked with is:

8. Check book records are one type of farm record. True or False

9. PCA, University of Missouri and Farm Bureau all sponsor "computer assisted" record systems and analysis. True or False

10. To file income tax reports, <u>you</u> must gross over:

    a. $1,000
    b. $2,050
    c. $600
    d. none of these (I983)

11. List four reasons for keeping good records.

    a.

    b.

    c.

    d.

12. A property list or inventory should be included in good records. True or False

13. The ASCS office here in the county will help keep records. True or False

14. Good records help increase income. True or False

15. Good records will highlight where and what management problems need attention. True or False.

16. Give an example of two livestock records that should probably be kept:

    a.

    b.

17. Give an example of two crop records that should probably be kept:

    a.

    b.

18. I should probably plan to get records up-to-date every:

    a. week
    b. month
    c. year

19. A record keeping farmer on an average will net more per year. True or False

20. Circle the type of record you do not need to keep to have good farm business records:

    a. receipts and expenses
    b. inventory
    c. amount spent on food for family

# EXAM #3

I. Make an entry on forms 6 to 8, indicating the following transactions:

1. January 5, 1983 - Bought 25 beef cows and 25 calves at Sedalia Sale Barn for $10,000. Check #125. Figured calves @ 150# and $100 per head. Cows averaged 1,000 pounds.

2. January 6, 1983 - Bought 500# hog supplement at L & M Supply @ $10.00/cwt.

3. January 7, 1983 - Paid Federal Land Bank annual real estate payment of $3,500 ($2,800 was principal - $700 interest) Check #126.

4. Add totals to line 25. Write on the page how to check for accuracy.

II. Make an entry on forms 2 to 4, indicating the following transactions:

1. January 4, 1983 - Borrowed $1,000 from Farmers & Traders Bank, Deposit Slip #101.

2. January 6, 1983 - Sold Joe Jones 150 bu. seed beans @ $10 per bu. Deposit slip #102.

3. January 10, 1983 - Sold 2,000 bu. corn to L & M Supply @ $3.40/bu.

4. January 11, 1983 - Sold cull cow that was raised (8 years old) to Radar Packing Co. Weight 900#. Received $180 net. Deposit slip $104.

5. Total to line 25, and show how to check for accuracy.

III. List the three factors we discussed during the Cash Flow lesson that can be used in evaluating a prospective investment:

1.

2.

3.

IV. On the depreciation forms, make the entries for the following items of crop machinery (first year of record is 1983):

1. January 5, 1983 - purchased a new John Deere 2030 tractor. Paid $4,000 difference. Traded in tractor which had a book value of $4,000. Use accelerated method investment credit, and expense $1000.

2. January 6, 1983 - purchased a used IH 10' disc. Paid $400 difference. Traded in disc which had book value of $100. Use straight line and investment credit.

# ANSWERS TO EXAMS

## EXAM #1

1. Answered to the satisfaction of the instructor

2. a. $21,000 x .08 = $1,680
   b. ($5,000 + $6,000) x .08 = $880.00
   c. $500 x .08 = 40

3. b

4. c

5. c

6. $8,000 x .15 = $1,200.00

7. (2,000 + 7,000) x .10 = $900.00

   Answer = D

## EXAM #2

1. True

2. True

3. True

4. True

5. More

6. Any four of these six:

   a. expenses and receipts
   b. depreciation and inventory
   c. summary and cash flow
   d. profit and loss statement
   ( ) net worth statement
   ( ) enterprise records

7. Missouri Young and Adult Farmer Record Book

8. True

9. True

10. D

11. a. lower tax liability
    b. improve management of farm
    c. easier to obtain credit
    d. makes farming more interesting

12. True

13. False

14. True

15. True

16. a. Feed
    b. Pounds produced

17. a. Fertilizer cost
    b. Machinery cost

18. a - week

19. True

20. c - amount spent on food for family

EXAM #3

NOTE: Answers to Exam #3 to the satisfaction of the instructor.

UNIT III - BUSINESS MANAGEMENT 3 days

Lesson 8 - How Can I Manage Taxes to Maximize Income?

Objective: Students will be able to manage taxes in order to maximize after tax income.

Study Questions:

1. What are some methods used to achieve maximum tax benefits?
2. What three areas can income be divided into?
3. What six areas can expenses be divided into?
4. Why is it important to maintain an even level of income?
5. What are some ways of delaying income?
6. What are some ways of moving income forward?
7. What is investment credit (I.C.) and how does it work?
8. What are the alternatives in using investment credit and how is it figured?
9. What is depreciation/cost recovery?
10. What is basis?
11. What is ACRS and to what does it apply?
12. What is expensing and how is it figured?
13. How do I determine the property class for an asset?
14. What methods of cost recovery are available under ACRS? How are the methods used?
15. What are suggestions on using depreciation/cost recovery for maximum advantage?
16. What does "capital gain" refer to?
17. What are some suggestions on using capital gains for maximum advantage?
18. What are some often overlooked items that should be checked?

References:

1. *Doane's Tax Management Guide and Supplement.* Pub. 225, Farmers' Tax Guide.
2. *Young and Adult Farmer Record Book.* IML.
3. Transparencies
   a. TM-III-15: Methods of Tax Management
   b. TM-III-16: Methods to Increase Income
   c. TM-III-17: Methods to Delay Income
   d. TM-III-18: Use Check List
   e. TM-III-19: Use Check List continued
   f. TM-III-20: Election to Expense
   g. TM-III-21: Classes of Property
   h. TM-III-22: Accelerated Cost Recovery System
   i. TM-III-23: ACRS Cost Recovery Tables for Real Estate
   j. TM-III-24: Straight Line Cost Recovery Method
4. Handouts
   a. HO-III-31: Income Tax Management for Farmers
   b. HO-III-32: Income Tax Estimate (Cash Method)
   c. HO-III-33: Details of Receipts and Expenses to Date (Transfer to page 1)
   d. HO-III-34: ACRS Information

UNIT III - BUSINESS MANAGEMENT

TEACHING PROCEDURE

A. Review the summary of previous lesson (if applicable)

B. Motivation: Farmers often pay more taxes than necessary. Some time spent studying taxes and the management of taxes may pay more per hour during off-seasons than any other activity that could be performed.

C. Assignment

D. Supervised study (consider breaking into 3 study periods.)

E. Discussion

1. List the seven suggested methods used to manage taxes on the board or overhead as students suggest them. Point out that these are the basis of our study in tax management.

   a. What are some methods used to achieve maximum tax benefits?

      1) Good records
      2) Even level of income
      3) Investment credit
      4) Depreciation method
      5) Capital gains
      6) Use check list
      7) Secure additional information

2. List the three groups that farm income can be divided into on the board. Refer to the record book on forms 2, 3 and 4 for example of entries that fit into each category. Give some examples of each and let student select the category.

   a. What three areas can income be divided into?

      1) Farm business income - forms 2 and 3 to Part I 1040F
      2) Sale of capital items - form 4 to Schedule 4797
      3) Non-farm income - Columns 18 and 19 of form 4 to 1040

3. List the six groups expenses can be divided into on the board. Refer to the record book on forms 7, 8, 9, 18 and 29. Use some of the "Sample Entries" for the record book from Lesson 1 of Business Management to let them practice entering the expenses on a 1040F, etc.

   a. What six areas can expenses be divided into?

      1) Deductible in year paid - form 7 and 8 to Part II 1040F
      2) Deductible at later date - column 39-40 of form 9 to lines 1 and 2 of Part I 1040F
      3) Deductible through depreciation - forms 12 - 18 to part III 1040F
      4) Deductible through alternative methods - forms 7 through 9
      5) Deductible when farm is sold - form 18
      6) Non-deductible expenses - forms 7 - 9

4. Discuss three reasons even level of income is important and work an example on the board using a current tax table and the example in HO-III-31 as a guide.

   a. Why is it important to maintain an even level of income?

      1) In year of high income, tax is figured at a higher precent of income
      2) In year of low or negative income, will lose personal exemptions and deductions
      3) In example in HO-III-31, almost a 50% savings in taxes by leveling the income

5. Have students discuss methods of delaying income to be sure they know how they work. An example of the deferred sales contract would be to deliver cattle in December, but not receive payment until January - need to have a contract stipulating when delivery is to be made, when payment is to be made, price, etc. There needs to be an advantage other than taxes. Often, a packer would agree to a premium to get the cattle in December - especially, if a lot of farmers are holding until after January 1. The others are probably self-explanatory.

   a. What are some ways of delaying income?

      1) Use deferred sales contract
      2) Advance payment of feed and fertilizer, etc.
      3) Postpone sales
      4) Expensing
      5) Purchase needed machinery, equipment, etc., before end of year to get investment credit and some depreciation
      6) Use accelerated depreciation
      7) Use income averaging

6. List six methods in increasing income on the board as students discuss them.

   a. What are some ways of moving income forward?

      1) Make more sales in current year
      2) Postpone expenses and investments until after January 1
      3) Pay bills after January 1
      4) Forego expensing
      5) Use straight line depreciation
      6) Do off-farm or custom work

7. Work examples on the board as in HO-III-31 with a new tractor purchased outright; a new tractor with a trade-in; and the purchase of a used tractor with and without a trade-in. Point out that this is a credit against taxes - not a deduction as depreciation.

   a. What is investment credit (I.C.) and how does it work?

      1) Direct allowance against taxes
      2) Must be taken on 3- and 5-year property
      3) Can be taken on new or used property
      4) When figuring basis on trade-ins, include remaining record book value of trade-in for I.C. when trading for new property, but not for used.
      5) Is recaptured for early disposition
         --20%/year for 5-year property
         --33%/year for 3-year property
      6) Can be carried back 3 years or forward up to 15 years

8. List the benefits of investment credit on the board and discuss.

   a. What are the alternatives in using investment credit and how is it figured?

      1) On 5-year property, use 10% of qualified basis and reduce basis for cost recovery by ½ the I.C. taken--or--use 8%, and basis for cost recovery remains the same.
      2) On 3-year property, use 6% of qualified basis and reduce basis for cost recovery by ½ of I.C. taken--or--use 4%, and basis for cost recovery remains the same.

      (NOTE: At this time the instructor should work through some sample problems. Discuss why farmers would want to use the various options when figuring investment credit.)

9. List the definition of depreciation and work some examples.

   a. What is depreciation/cost recovery?

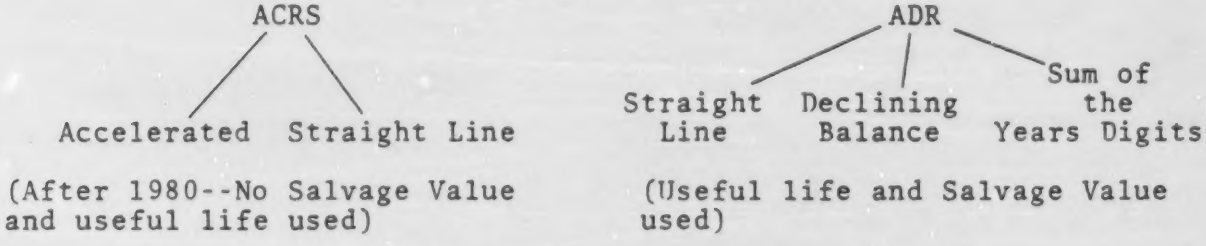
      1) Is a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in your business or held for income
      2) Must be taken in year placed in service.

10. Use Form 12 in the Record Book to figure "basis" of a few examples. Include with and without trade-ins, different book values, etc.

    a. What is basis?

       1) Cost of new or used property, just purchased
       2) Depreciated value of property you have owned
       3) Book value of traded in property plus "boot" paid if equipment traded for is new
       4) It is not "list price" or "replacement cost"

11. Put ACRS on chalkboard and distinguish it from the old ADR system.




    a. What is ACRS and to what does it apply?

       1) ACRS was established by the Economic Recovery Act of 1981, and completely changed the way depreciation is figured on agricultural capital assets for tax purposes
       2) ACRS methods are the same for both new and used items
       3) Applies to all capital assets--useful life of one year or more

12. Place TM-III-20/HO-III-34 on overhead with the heading "Election to Expense" showing. Ask for student input as to what expensing is before going further.

    a. What is expensing and how is it figured?

       1) Expensing replaces additional 20% depreciation
       2) Expensing allows quick write-off
       3) Can only expense cash difference paid
       4) Can only expense items that qualify for investment credit

5) Can expense any or all of an item or combination of items up to the maximum
6) Investment credit is lost on amount expensed

(Note: Use TM-III-20/HO-III-34 to now show maximum amounts. Show a couple of examples of expensing, one being a combination of items.)

13. Have students help compile a list of commonly purchased farm items.

a. How do I determine the property class for an asset?

1) Use TM-III-21/HO-III-34 as a handout to students. This will show which property to place in each class.
2) Students need to commit these classes to memory.

14. List the two types of depreciation on the board. Work samples of each kind, using 3, 5, and 15-year property. Students should identify the advantages of using one method over the other.

a. What methods of cost recovery are available under ACRS?

1) Accelerated
2) Alternate Straight Line

b. How are the methods used?

1) Accelerated
--Determine class of property
--Determine basis for cost recovery
--Basis x % = cost recovered (regardless of date purchased)

Figure 2 or 3 examples all the way through to show that 100% of cost is recovered. (Use TM-III-22 & TM-III-23/HO-III-34 to get %'s and show how they work.)

Example 1 - Farmer A purchases a combine for $15,000. How does he recover the cost? Claim maximum I.C. allowed.

Answer: $15,000 (basis) x .10 (I.C. Rate) = $1500 (I.C. claimed) - $750 (basis reduced by ½ I.C. claimed) = $14,250 (basis for cost recovery)

1st year $14250 x .15 = 2137.50 cost recovery
2nd year $14250 x .22 = 3135.00 cost recovery
3rd year $14250 x .21 = 2992.50 cost recovery
4th year $14250 x .21 = 2992.50 cost recovery
5th year $14250 x .21 = 2992.50 cost recovery

Example 2 - Farmer B had a machine shed built in June, 1982 at a cost of $6,600. How much I.C. can be taken? What is the amount recovered for the first 3 years?

Answer:

1. No Investment credit can be taken since it falls in the 15-year property classification.

2.

| Year | | Prorated Percentage | | Amount recovered |
|---|---|---|---|---|
| 1 | $6,600 | x | .07 | = $462.00 |
| 2 | $6,600 | x | .11 | = $762.00 |
| 3 | $6,600 | x | .10 | = $660.00 |

2) Alternate Straight Line

--Determine class of property
--Determine basis for cost recovery
--Choose recovery period
--Basis ÷ years (÷ 2 for 1st year on 3- and 5-year property.) (Prorated by month for 15-year property.)

Figure 2 or 3 examples to show how this method works and differs from accelerated cost recovery. Use TM-III-24/HO-III-34 to show optional straight line recovery period.

Example 1 - Farm A buys 6 gilts at $200 each. Taking maximum I.C., what will his cost recovered be for each year?

Answer: 6 x $200 = $1200 (basis). $1200 x .06 (I.C. rate) = $72.00 (I.C. taken). Reduce basis by ½ I.C. taken ($36) = $1164 basis for regular depreciation. 1st year, $1164 ÷ 2 = $194.00 cost recovery

2nd year = $388.00 cost recovery
3rd year = $388.00 cost recovery
4th year = $194.00 cost recovery

Example 2 - Farmer B buys a new tractor, paying $25,000 cash and trading in a used tractor with a book value of $12,000. Use I.C. rate that will not reduce his basis. What will his recovered cost be for each year?

Answer: $25,000 (cash) + $12,000 (trade-in) = $37,000. $37,000 x .08 (I.C. rate) = $2960 (I.C. taken). 1st year cost recovery - $37,000 ÷ 5 = $7400 ÷ 2 = $3700

2nd year cost recovery = $7400
3rd year cost recovery = $7400
4th year cost recovery = $7400
5th year cost recovery = $7400
6th year cost recovery = $3700

15. List the two methods on board and discuss briefly since they have all been referred to previously.

    a. What are suggestions on using depreciation/cost recovery for maximum advantage?

        1) Use accelerated method if you owe tax
        2) Use Forms 12 to 18 in Record Book to keep accurate record of depreciation
        3) Use straight line method in years of low taxes to save deductions until needed later on

16. Have the definition listed on the board. Ask the class for examples of qualifying items. Also, refer to IRS Form 4797 and Schedule D and work an example as in Farmers' Tax Guide.

    a. What does capital gain refer to?

        1) Capital gain is the amount of increase in value on capital items. As an example, if a gilt is raised and kept for a sow, then sold for $150 as a cull sow; tax would be paid on $75. (Assumes cost of raising is deducted as an operating expense.)

17. List these on the board as students suggest them with a brief explanation.

    a. What are some suggestions on using capital gains for maximum advantage?

        1) Use gilts for 1 litter; sell; replace
        2) Keep breeding cattle 24 months
        3) Trade income producing property as farms if possible, rather than selling one and buying another

18. Discuss these as they are listed.

    a. What are some often overlooked items that should be checked?

        1) Dues to farm organizations
        2) Costs of farm magazines and other reference and business material
        3) Farm share of utility (including phone, electricity, office part of heat) bills
        4) Postage, stationery, records, etc.

5) Office in home (depreciation of that part, electricity, heat, etc.)
6) Safe deposit box rentals
7) Wages to children (this has a lot of tax savings if you qualify); and/or let children have livestock, crops, etc.
8) Mileage on family car @ 20.5¢ for farm business (including attending adult farmer classes) (1983 Tax Guide)
9) Mileage on family car @ 9¢ for charitable and medical purposes (1983 Tax Guide)
10) Deduct the cost of child care so your spouse can help with farm work (check limitations)
11) Political contributions
12) Set up a retirement plan (get help on this one)
13) Use "income averaging" any year your current income is sharply higher (get average income for last 4 years - multiplying by 120% - if current income is $3,000 more than this figure get Schedule G or 1040 and figure it out)
14) Interest in an amortized loan
15) Consider alternative forms of business organization - partnership - corporation if taxes are high
16) If age 63 or 64, consider delaying income to 65 to get double exemption
17) At retirement, shift income to rents, interest, etc.
18) Check for "loss years" in the past that could be carried forward
19) Be sure to deduct cost of purchased livestock that are lost, strayed, stolen or died
20) Itemize all entries on bank deposit slips
21) Make an estimate of taxes prior to year's end so adjustments can be planned (use forms attached)

If time is available, the example entries used in Lesson 1 on Farm Records could be recorded on IRS Forms so students understand how it fits together. Good tax management is more important than completing a form, though.

F. Summary: As a summary, list the seven points in good tax management from question 1.

G. Exam

# METHODS OF TAX MANAGEMENT

1. COMPLETE AND ACCURATE RECORDS.

2. MAINTAIN "EVEN" LEVEL OF INCOME.

3. USE INVESTMENT CREDIT TO HIS BENEFIT.

4. USE THE PROPER DEPRECIATION METHODS FOR HIS SITUATION.

5. USE CAPITAL GAIN PROVISIONS.

6. USE A CHECK LIST OF ALLOWABLE DEDUCTIONS TO BE SURE ALL ARE CLAIMED.

7. SECURE ADDITIONAL INFORMATION.

# METHODS TO INCREASE INCOME

A. SELL MARKETABLE GRAIN, LIVESTOCK, ETC., BEFORE DECEMBER 31.

B. POSTPONE EXPENDITURES AND INVESTMENTS UNTIL JANUARY 1.

C. WORK WITH SUPPLIERS TO PAY BILLS AFTER JANUARY 1.

D. FOREGOING EXPENSING

E. USE STRAIGHT LINE DEPRECIATION.

F. DO SOME OFF-FARM OR CUSTOM WORK.

# METHODS TO DELAY INCOME

A. USE DEFERRED SALES CONTRACTS.

B. MAKE ADVANCE PURCHASES OF FEED AND FERTILIZER (MUST BE FIRM AND HAVE AN ADVANTAGE).

C. POSTPONE SOME SALES UNTIL NEXT YEAR.

D. USE EXPENSING

E. PURCHASED NEEDED MACHINERY, EQUIPMENT, ETC., BEFORE END OF THE YEAR TO GET INVESTMENT CREDIT AND SOME DEPRECIATION.

F. USE ACCELERATED DEPRECIATION.

G. USE "INCOME AVERAGING" IF INCOME $3,000 ABOVE 120% OF 4 YEAR AVERAGE

# USE CHECK LIST

A. DUES TO FARM ORGANIZATIONS.

B. COSTS OF FARM MAGAZINES AND OTHER REFERENCE AND BUSINESS MATERIAL.

C. FARM SHARE OF UTILITY (INCLUDING PHONE, ELECTRICITY, OFFICE PART OF HEAT) BILLS.

D. POSTAGE, STATIONERY, RECORDS, ETC.

E. OFFICE IN HOME (DEPRECIATION ON THAT PART, ELECTRICITY, HEAT, ETC.)

F. SAFE DEPOSIT BOX RENTALS.

G. WAGES TO CHILDREN (THIS HAS A LOT OF TAX SAVINGS IF YOU QUALIFY); AND/OR LET CHILDREN HAVE LIVESTOCK, CROPS, ETC.

H. MILEAGE ON FAMILY CAR @ 20.5¢ FOR FARM BUSINESS (INCLUDING ATTENDING ADULT FARMER CLASSES). (1983 TAX GUIDE)

I. MILEAGE ON FAMILY CAR @ 9¢ FOR CHARITABLE AND MEDICAL PURPOSES. (1983 TAX GUIDE)

J. POLITICAL CONTRIBUTIONS.

K. DEDUCT THE COST OF A BABY SITTER SO YOUR WIFE CAN HELP WITH FARM WORK (CHECK LIMITATIONS).

L. SET UP A RETIREMENT PLAN (GET HELP ON THIS ONE).

M. USE "INCOME AVERAGING" ANY YEAR YOUR CURRENT INCOME IS SHARPLY HIGHER (GET AVERAGE INCOME FOR LAST 4 YEARS - MULTIPLY BY 120% - IF CURRENT INCOME IS $3,000 MORE THAN THIS FIGURE GET SCHEDULE G OF 1040 AND FIGURE IT OUT).

N. INTEREST IN AN AMORTIZED LOAN.

O. CONSIDER ALTERNATIVE FORMS OF BUSINESS ORGANIZATION - PARTNERSHIP-CORPORATION IF TAXES ARE HIGH.

P. IF AGE 63 OR 64, CONSIDER DELAYING INCOME TO 65 TO GET DOUBLE EXEMPTION.

Q. AT RETIREMENT, SHIFT INCOME TO RENTS, INTEREST, ETC.

R. CHECK FOR "LOSS YEARS" IN THE PAST THAT COULD BE CARRIED FORWARD.

S. BE SURE TO DEDUCT COST OF PURCHASED LIVESTOCK THAT ARE LOST, STRAYED, STOLEN, OR DIED.

T. ITEMIZE ALL ENTRIES ON BANK DEPOSIT SLIPS.

U. MAKE AN ESTIMATE OF TAXES PRIOR TO YEAR'S END SO ADJUSTMENTS CAN BE PLANNED (USE FORMS ATTACHED).

UNIT III - BUSINESS MANAGEMENT

# INCOME TAX MANAGEMENT FOR FARMERS*

Objective - The goal of income tax management is to maximize after-tax income. Because many decisions made by a farmer during the year affect his after-tax income, a good farm manager will "think taxes" all 12 months so his day-to-day decisions result in the greatest tax advantage. Many farmers will want the help of a professional tax man in preparing their tax return. However, it must be remembered that the tax man is limited in what he can do after the year is complete; he is limited by the information provided by the farmer, and the farmer is still responsible for the accuracy and full payment of taxes.

Some methods good managers use to achieve maximum tax benefits will include the following:

1. Complete and accurate records.
2. Maintain "even" level of income.
3. Use investment credit to his benefit.
4. Use the proper depreciation methods for his situation.
5. Use capital gain provisions.
6. Use a check list of allowable deductions to be sure all are claimed.
7. Consider alternative business organization as corporations.
8. Secure additional information.

It is planned to have a brief discussion of each of these points, so the beginning teacher will be familiar with the importance and provisions of each point.

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*Since about 97% of the farmers report on the cash basis, this handout is on that basis.

1. GOOD RECORDS: Records are of more importance for the management of the over-all farm business than for income tax purposes; but they are essential for income tax use. Many types and forms may be used. One of the best record systems is the Missouri Young Farmer Record Book available from the local Vocational Agriculture Department or Instructional Materials Laboratory, 10 Industrial Education Building, University of Missouri-Columbia, Columbia, Missouri 65201. It has the forms that will permit a farmer to keep the necessary tax records. Computer type record services are also excellent and include those available through the Extension service, local Production Credit Associations, and local Farm Bureaus. All of these will provide the necessary tax information in addtion to management information. You should refer to pages 18 and 30 in the 1975 Internal Revenue Farmers Tax Guide for examples of forms that will provide this information if you decide not to use one of the systems mentioned above.

Income needs to be divided into three sources: (1) farm business income (from forms 2 and 3) which is reported in Part I of 1040F; (2) income from sale of capital (from form 4) which is reported on Schedule 4797; and (3) non-farm income (from columns 18 and 19 of form 4) which, other than money borrowed, is reported on Schedule 1040.

Expenses need to be divided into six groups: (1) expenses deductible in year paid (from forms 7 and 8 - some items as utilities may be part farm and part non-farm) which are reported in Part II of 1040F; (2) expenses deductible at a deferred date (from form 9 - columns 39-41) which are reported on lines 1 and 2 of Part 1 of 1040F; (3) expenses charged through depreciation (from form 9 - columns 42-45 and transferred to forms 12-18) and reported in Part III of 1040F; (4) expenses with alternative tax treatments (from forms 7-9) - examples are soil and water conservation practice, clearing land. (Use Farmer's Tax Guides for reference); (5) expenses not deductible until farm is sold (from form 18) as an example cost of land; (6) expenses not deductible (from forms 7-9) - as an example feed fed livestock butchered for home consumption and personal part of insurance, taxes, utilities, etc.

2. MAINTAIN AN "EVEN" LEVEL OF INCOME: Extreme variability of prices and production, without some "income management" can lead to seriously inflated income taxes. For example, a family of four that earns (adjusted gross income) $15,000 one year and none the next who takes a standard deduction and has no tax credits, would pay $1,607 income tax on 1975 rates. The same family earning the same total amount over the two year (7,500/year) - but evenly divided between the two years would pay over a $1,000 less this amount - or $524. Using records to make an eleven month income estimate coupled with appropriate timing of sales and purchases in the final month - will often permit leveling out of income and some large tax savings. (Keep your income high enough to avoid loss of deductions.)

Some methods to delay income to maintain an "even" level of income could be:

a. Use deferred sales contracts.

b. Make advance purchases of feed and fertilizer (must be firm and have an advantage).

c. Postpone some sales until next year.

d. Use expensing

e. Purchase needed machinery, equipment, etc., before end of the year to get investment credit and some depreciation.

f. Use accelerated depreciation.

g. Use "income averaging" if income $3,000 above 120% of 4 year average.

Some methods to increase income in the present year could be:

a. Sell marketable grain, livestock, etc., before December 31.

b. Postpone expenditures and investments until after January 1.

c. Work with suppliers to pay bills after January 1.

d. Foregoing expensing

e. Use straight line depreciation.

f. Do some off-farm or custom work.

3. USE INVESTMENT CREDIT TO HIS BENEFIT: Investment credit is a direct credit allowance against taxes due on certain investments. It is claimed the year the item is placed in service, which is the year you normally start depreciation.

Generally, investment credit is allowed on all depreciable tangible personal property including livestock acquired for breeding or dairy purposes (except horses) plus other if (a) used as an integral part of manufacturing or production (b) constitutes a research or storage facility used in connection with these activities.

Some examples of qualifying items: farm machinery, breeding livestock, tile drains, feeding floors, water systems outside of a building, depreciable drainageways, fences, gates, bins, silos,

outside electrical installations, buildings if an integral part of production - as an example confined feeding system.

The sum of the basis of all new eligible property qualifies. On used property, qualification is limited to the cost of cash difference paid; (as an example, if a new tractor is bought with a cash difference of $10,000 and the tractor traded in has a book value of $5,000, the basis of the new tractor is $15,000. Investment credit is taken on the $15,000. If an item is used, investment credit is taken only on the cash difference or $10,000. Livestock are considered new if put to its first use by the taxpayer.

The extent of credit that qualified is:

| Classification | % of cost or basis |
|---|---|
| 3 year property | 100 |
| 5 year property | 100 |

As of 1983, the investment credit (I.C.) taken is dependent upon property classification and the tax situation of the individual. Property which is classified as 5-year can have 10% of the basis claimed for I.C., but the basis must then be reduced by ½ the I.C. amount for regular cost recovery-or-use 8% I.C. rate, and the basis for cost recovery remains the same. For property which falls into the 3 year classification, I.C. can be taken at a rate of 6% the qualified basis, with ½ the I.C. amount taken off the basis for regular cost recovery-or-use 4% I.C. rate, and the basis for cost recovery remains the same. In the example above, the tractor falls into the 5-year property classification. If the farmer chose to use 10% I.C. in the first problem, he would receive $1500 I.C., and his basis for regular cost recovery would now be $14,250. Had he selected to use 8% I.C., he would have received $1200 I.C., and his basis for cost recovery would have remained at $15,000 ($10,000 cash + $5,000 trade-in on new tractor).

The amount of credit is limited to:

1. The tax liability
2. Unused credit can generally (check this) be carried back three years and forward 15 years.

Tips:

1. Investment credit must be taken on 3- and 5-year property.
2. When to expense an item rather than depreciate and take investment credit? Varies by individuals, but depreciation/cost recovery will recover all costs and you get the investment credit in addition. A $50 item may not be worth the trouble.

3. If you buy a farm, take investment credit on all qualified items on the farm as fences, water systems, etc.

4. Secure Publication 572, "Tax Information on the Investment Credit" from Internal Revenue for more details.

4. USE THE PROPER DEPRECIATION/COST RECOVERY METHOD FOR HIS SITUATION: The cost of your machinery, equipment, farm buildings, and other property with a useful life of more than 1 year is a capital expenditure and may not be deducted as an expense in the year of purchase. However, you are entitled to deduct, as depreciation, a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in your business or held for the production of income.

The gain on disposition of depreciable property may have to be reported as ordinary income, to the extent of depreciation taken, regardless of how long you held the property.

Depreciation/cost recovery must be taken in the year it is sustained. Use a form which furnished you (1) a record of your depreciable assets, (2) your depreciation allowance, and (3) information you will need to determine the adjusted basis of your depreciable assets if you sell or trade them. Forms 12-18 in the record book are excellent for this.

The property must be placed in one of four useful life categories, which are based upon that type of property. For example, swine always fall in the 3-year class and cattle in the 5-year class, and these can never be changed. Land is never depreciable because its useful life is indefinite. The first step to figuring cost recovery is to place each item on your schedule in its correct category. Use TM-III-21/HO-III-34 as a reference for placing items in the correct classification for regular cost recovery. Also, salvage value is no longer claimed, and every item is recovered for its entire price.

The basis for determining depreciation is the same as the basis you would use to determine your gain if you sold the property. Usually, the cost of property is its basis. Or if you have a trade-in, it is book value plus "boot" paid.

The depreciation deduction is never determined by reference to replacement cost of "list" price.

Expensing: This process replaces the old 20% additional first-year depreciation, and allows for quick write-off of any number of items up to the maximum dollar unit. Expensing can only be done on the cash difference paid, and only on those items which qualify for investment credit. Investment credit is lost on any amount expensed, so one would usually use it only in years when large tax deductions are needed. Use TM-III-20/HO-III-34 as a reference on amounts that can be expensed in a given year.

Methods of Figuring Cost Recovery: Under ACRS, there are two ways in which items may be recovered--the Accelerated and Straight Line Methods.

Different Methods for Different Assets: You are allowed under ACRS to use different methods on different classes of assets. You must, however, use the same method on all items within the same classification for a given year. Example: If you wish to use the accelerated method on an item in the 3-year class in 1982, all 3-year items purchased in 1982 must be placed on the accelerated schedule.

The Two Cost Recovery Methods Compared: The following table shows a detailed comparison of the two cost recovery methods found under the ACRS system. The cost recovery in each case is based on the fact that a new tractor was purhcased for $15,000, plus a $5,000 trade-in, bringing the basis for regular cost recovery to $20,000. (Assume we claimed 8% investment credit for no reduction in basis for cost recovery)

| | Annual Cost Recovery | |
|---|---|---|
| Year | Accelerated | Straight Line |
| Expensed Amount | -0- | -0- |
| First Year Regular Cost Recovery | $ 3,000 | $ 2,000 |
| Second Year | $ 4,400 | $ 4,000 |
| Third Year | $ 4,200 | $ 4,000 |
| Fourth Year | $ 4,200 | $ 4,000 |
| Fifth Year | $ 4,200 | $ 4,000 |
| Sixth Year | -0- | $ 2,000 |
| Total Cost Recovered | $20,000 | $20,000 |

NOTE: Expensing was not elected as we would have lost investment credit on any amount deducted.

Tips on using cost recovery to your advantage:

(a) Use the accelerated method of cost recovery if income is high and tax deductions are needed. This allows you to get the maximum amounts of deductions in the years they are needed. However, if income is low, the farmer should elect the straight line method. This allows for a spreading out of deductions over a longer period of time, so that they might be saved for some future time when income is high and deductions are needed.

(b) Use Forms 12-18 in the Young Farmer Record Book to keep accurate, permanent record of farm business cost recovery. The following charts summarize cost recovery rules.

"QUICK REFERENCE CHART ON RULES FOR CLAIMING DEPRECIATION"*

| | Property | Useful Life | Basis | Method | Exchanges | Limitations | Special Rules |
|---|---|---|---|---|---|---|---|
| Expensing | Tangible personal property purchased, new or used. | Over 1 year | Cost. Does not apply to property acquired by death or gift or which has basis of transfer. | Can expense any or all of a number of items up to set limitations | Applies only to cash boot paid. | Must be eligible for I.C to qualify; based on year property is purchased | Taken only in first year of regular depreciation. Does not apply to trusts. Lose I.C. on any amou that is expensed |
| Ordinary Depreciation (mandatory) | All depreciable property, new or used. | Over 1 year. | Adjusted basis | Straight-line, accelerated | Use basis of property acquired, usually basis of old plus boot. | Must be placed in specific categories for regular depreciation | No salvage value Must use same method on like property in same year |

"QUICK REFERENCE CHART TO RULES ON RECAPTURE"*

| | What Recaptured | Amount Recaptured | Special Rules | Tax-Free Exchanges | Death, Gift, Other |
|---|---|---|---|---|---|
| Recapture of Depreciation on Property other than Real Estate. IRC Sec. 1245 | Depreciation claimed on tangible and intangible personal property and other tangible property used in farming or for farm storage or research (except buildings). Includes livestock after 1969. | Lesser of gain or depreciation after 1961 (livestock after 1969) | Gain not recaptured is Sec. 1231 or capital gain if asset held over 6 months (livestock 12 or 24 months) Subject to EDA recapture. See below. | Recapture limited to recognized gain plus value of nondepreciable property not treated as gain. Potential recapture carries over to new property. | No recapture on death; no carry-over to estat No income on gift but donee succeeds to recapture. Charitable gift reduced by recapturable depreciation. |
| Recapture of Depreciation on Real Estate deducted before 1970. IRC Sec. 1250 | Excess of fast depreciation over straight line claimed on bldgs. and other realty not included under Sec. 1245 above. | "Applicable precentage"of lesser of gain or excess depreciation from 1964 through 1969. | "Applicable percentage" is 100% reduced by one percentage point for every mo. over 20 that property was held. No recapture if held over 10 years. Gain not recaptured is Sec. 1231 or capital gain. Post 1969 excess depreciation is recaptured first. Not subject to EDA recapture. See below. | Same as above. | Same as above. No recapture on residence except part used for business. |
| Recapture of Depreciation on Real Estate deducted after 1969. IRC Sec. 1250 | Same as above. | Lesser of gain or excess depreciation claimed after 1969. | Post-1969 excess depreciation is recaptured before 1963-69 excess depreciation. See above. Gain not recaptured is Sec. 1231 or capital gain. Not subject to EDA recapture. See below. | Same as above. | Same as above. |

"QUICK REFERENCE CHART TO RULES ON RECAPTURE"* (cont'd)

| | What Recaptured | Amount Recaptured | Special Rules | Tax-Free Exchanges | Death, Gift, Other |
|---|---|---|---|---|---|
| Recapture of Land Expenditures IRC Sec. 1252 | Soil & water conservation expense deductions under Sec. 175 and land-clearing expense deductions under Sec. 182. | Lesser of gain or percentage of land expense deductions based on period land was owned. | Percent of deductions recaptured if land held:<br>Over 10 yrs. none<br>9 years 20%<br>8 years 40%<br>7 years 60%<br>6 years 80%<br>5 years or less 100%<br>EDA recapture applies first. | Same as above. | Same as above. Allocation on sale of part of land. |
| Recapture of Farm Losses in Excess Deductions Account (EDA). IRC Sec. 1251 | Accumulated farm losses in individuals and Subchapter S corporations in excess of $25,000 in years in which non-farm income exceeds $50,000. All farm losses of corporation, estate or trust. | Lesser of gain on "farm recapture property" or balance in EDA. Only land deductions for 5 years on sale of land. | Farm recapture property is depreciable property, livestock, unharvest crops and land under Sec. 1231, but not buildings. EDA is increased by losses reduced by farm income and amounts recaptured. | Same as above; except special rules for formation of corporations and partnership. | No recapture on death; no carry-over to estate. On gift, if potential gain on property given esceeds 25% of potential gain on property of donor, donee succeeds to proportionate share of donor's EDA. |
| Recapture of Investment Credit. IRC Sec. 47 | "Unearned" credit claimed on tangible personal property & other tangible property used in farming or for farm storage or research (except bldgs.). | Difference between credit claimed and credit based on period property held is added to tax. | Credit repealed as of April 19, 1969. No recapture on casualty or theft loss. Limited (or no), recapture if property replaced within 6 months. For the credit enacted in 1971, recapture applies to casualties & thefts. | Recapture on exchange, involuntary conversion; not on mere change of business form. | Recapture on gift; not on death. Recaptu if business use ceases |





*erence charts courtesy "Doane's Tax Management Guide" Doane Agricultural Service, 8900 Manchester Rd., St. Louis, Missouri

| Asset guideline class | Description of assets included | Asset depreciation range (in years) | | | Annual Asset Guideline Repair Allowance Percentage |
|---|---|---|---|---|---|
| | | Lower limit | Asset guideline period | Upper limit | |
| 01.0 to 79.0 | DEPRECIABLE ASSETS USED IN THE FOLLOWING ACTIVITIES: | | | | |
| 01.0 | Agriculture: Includes only such assets as are identified below and that are used in the production of crops or plants, vines and trees (including forestry); the keeping, grazing, or feeding of livestock for animal products (including serums), for animals increase, or value increase; the operation of dry lot or farm dairies, nurseries, greenhouses, sod farms, mushroom cellars, cranberry bogs, apiaries, and fur farms; the the production of bulb, flower, and vegetable seed crops; and the performance of agricultural, animal husbandry and horticultural services. | | | | |
| 01.1 | Machinery and equipment, including grain bins and fences but no other land improvements ..... | 8 | 10 | 12 | 11.0 |
| 01.2 | Animals: | | | | |
| 01.21 | Cattle, breeding or dairy ..... | 5.5 | 7 | 8 | |
| 01.22 | Horses, breeding or work ..... | 8 | 10 | 12 | |
| 01.23 | Hogs, breeding ..... | 2.5 | 3 | 3 | |
| 01.24 | Sheep and goats, breeding ..... | 4 | 5 | 6 | |
| 01.3 | Farm Buildings ..... | 20 | 25 | 30 | 5.0 |

5. USE CAPITAL GAIN PROVISIONS:

(a) a new form - 4797 - replaces Schedule D in reporting sales and exchanges of business property. Schedule D is now used only to report gains and losses on stocks, bonds, and similar investments.

(b) sales of livestock that were purchased for dairy, breeding or work purposes and sales of livestock that were raised and held for dairy, breeding or work purposes are reported on this form. The advantage in getting as much of the sales reported here is that only 40% of the "capital gain" is reported as income. Examples of places to report items are in Table B.

(c) "capital gain" on purchased livestock that qualifies is sale price less unrecovered cost and cost of sale. (Beginning 1983, recovered costs will be treated as ordinary income and any amount above that will be considered "capital gains". For example: a farmer has recovered $500 in costs on a bull he sells for $800. The first $500 will be considered ordinary income, while the final $300 will be reported as "capital gains".)

(d) gain on raised livestock that qualifies is selling price less cost of sale.

(e) to qualify, purchased livestock acquired before December 31, 1969 must be held 12 months or more. Cattle and horses acquired after December 31, 1969 must be held 24 months or more; other (hogs) still 12 months or more. Raised livestock must meet the same qualifications as purchased livestock.

(f) livestock purchased for resale are reported in the year of sale. For farmers handling a volume of feeder livestock and buying and selling during the year, determining the cost of livestock sold during the reporting year might be a problem. One method that might simplify this is to use the following formula (cost of purchased livestock on hand January 1, PLUS cost of purchased livestock bought during the year MINUS cost of purchased livestock on hand December 31, EQUALS cost of purchased livestock sold during the year). For farmers handling a volume this will also help them in accounting for death loss of purchased livestock.

Tips: To qualify the maximum amount under these provisions, some farmers do the following:

(a) use gilts for one litter; sell; replace with gilts

(b) keep breeding cattle at least 24 months

(c) trade income producing property, as farms rather than selling one and buying another. Get help on this prior to entering the deal

(d) shift as much income as possible to qualify for capital gains

(e) use installment sales of property to spread income over years and avoid high income in one year. Be sure to get advice on this prior to offering a farm, etc., for sale

(f) additional information should be secured on this important point to make maximum use of it.

TABLE B

| Below are common examples of items reportable on this form. Columns (b) and (c) indicate the part in Form 4797 in which they first should be entered | Held six months or less | Held more than six months |
|---|---|---|
| (a) | (b) | (c) |
| 1. Depreciable trade or business machinery: | | |
| (a) Sold or exchanged at a gain .... | Part II | Part III |
| (b) Sold or exchanged at a loss ... | Part II | Part I, Section B |
| 2. Depreciable realty, used in trade or business: | | |
| (a) Sold or exchanged at a gain ... | Part II | Part III |
| (b) Sold or exchanged at a loss ... | Part II | Part I, Section B |
| 3. Cattle and horses, used in a trade or business, held for draft, breeding, dairy, or sport purposes: | | |
| (a) Acquired after December 31, 1969, held for a period of less than 24 months from date of acquisition, sold at a gain or loss .. | Part II | Part II |
| (b) Acquired before January 1, 1970 | | |
| (1) Sold at a gain ..... | Not applicable | Part III |
| (2) Sold at a loss ..... | Not applicable | Part I, Section B |
| 4. Livestock, other than cattle and horses, used in a trade or business, held for draft, breeding, dairy, or sport purposes: | | |
| (a) Held for a period of less than 12 months from date of acquisition, sold at a gain or loss | Part II | Part II |
| (b) Held for a period of 12 months or more from date of acquisition | | |
| (1) Sold at a gain ..... | Not applicable | Part III |
| (2) Sold at a loss ..... | Not applicable | Part I, Section B |
| 5. Farm land, held less than 10 years, upon which soil, water, and/or land clearing expenses were deducted after December 31, 1969: | | |
| (a) Sold at a gain ..... | Part II | Part III |
| (b) Sold at a loss ..... | Part II | Part I, Section B |
| 6. An individual's personal automobile was stolen ..... | Complete Form 2684 | Part I, Section A; or, as an alternative complete Form 4684 |

6. USE A CHECK LIST TO BE SURE ALL QUALIFYING DEDUCTIONS ARE USED:

An example of items on a check list would be the following:

(a) dues to farm organizations

(b) costs of farm magazines and other reference and business material

(c) farm share of utility (including phone, electricity, office part of heat) bills

(d) postage, stationery, records, etc.

(e) office in home (depreciation on that part, electricity, heat, etc.)

(f) safe deposit box rentals

(g) wages to children (this has a lot of tax savings if you qualify); and/or let children have livestock, crops, etc.

(h) mileage on family car @ 20.5¢ for farm business (including attending adult farmer classes)

(i) mileage on family car @ 9¢ for charitable and medical purposes

(j) political contributions

(k) deduct the cost of a baby sitter so your wife can help with farm work (check limitations)

(l) set up a retirement plan (get help on this one)

(m) use "income averaging" any year your current income is sharply higher (get average income for last 4 years - multiply by 120% - if current income is $3,000 more than this figure get Schedule G of 1040 and figure it out)

(n) interest in an amortized loan

(o) if age 63 or 64, consider delaying income to 65 to get double exemption

(p) at retirement, shift income to rents, interest, etc.

(q) check for "loss years" in the past that could be carried forward

(r) be sure to deduct cost of purchased livestock that are lost, strayed, stolen or died

(s) itemize all entries on bank deposit slips

(t) make an estimate of taxes prior to year's end so adjustments can be planned

7. CONSIDER ALTERNATIVE FORMS OF BUSINESS ORGANIZATION: partnership, corporation if taxes are high.

8. SECURE ADDITIONAL REFERENCES AND INFORMATION:

This paper has intentionally been brief in order to assist the beginning teacher to become acquainted with some parts of managing that part of the farm business as it relates to income taxes.

Some references which may be secured that will clarify rulings and management procedures would be the following:

(a) Publication 225 *Farmers Tax Guide* - IRS

(b) Extension Farm Management Newsletter on Income Taxes - Extension Service

(c) *Income Tax Management for Farmers* - North Central Publication #2, Revised 1970, Extension Service.

(d) Missouri Farm Management Publication 6940 *"Farm Records"* Extension Service

(e) Publication 534, *Depreciation, Amortization and Depletion* - IRS

(f) Publication 506, *Computing Your Taxes Under the Income Averaging Method* - IRS

(g) Publication 503, *Child Care and Disabled Dependent Care* - IRS

(h) Publication 572, *Tax Information on Investment Credit* - IRS

(i) Publication 547, *Tax Information on Disasters, Casualty Losses, Thefts* - IRS

(j) *Instructions for Form 4832, Asset Depreciation Range* - IRS

(k) *Instructions for Form 4797, Supp. Schedule of Gains and losses* - IRS

(l) *Doane's Tax Management Guide and Supplement* - Doane Agriculture Service, Inc.

(m) *Farm Income Tax Manual* - by John C. O'Bryne - Doane Agriculture Service, Inc.

UNIT III - BUSINESS MANAGEMENT

Page 1

WORKSHEET I - INCOME TAX ESTIMATE (Cash Method)

| Column 1<br>Item | Column 2<br>Present Estimate | | Column 3<br>Possible Additional Sales or Purchases | | Column 4<br>Revised Estimate |
|---|---|---|---|---|---|
| 1. Gross Farm Profits (Page 2; line 6) | $_____ | + | $_____ | = | $_____ |
| 2. Cash Farm Expenses (Page 2; line 22) | $_____ | + | $_____ | = | $_____ |
| 3. Self-employed Farm Income (line 1-2) | $_____ | + | $_____ | = | $_____ |
| 4. Net Taxable Gain From Sale of Capital Items (Form 4797 & Schedule D) | $_____ | + | $_____ | = | $_____ |
| 5. Other Taxable Income (Non-farm) | $_____ | + | $_____ | = | $_____ |
| 6. Adjusted Gross Income (Line 3, 4, 5) | $_____ | + | $_____ | = | $_____ |
| 7. Personal Exemptions and Deductions* | $_____ | + | $_____ | = | $_____ |
| 8. Taxable Income (line 6-7) | $_____ | + | $_____ | = | $_____ |
| 9. Estimated Income Tax (from tax tables) | $_____ | + | $_____ | = | $_____ |
| 10. Estimated Self-employment tax (the smaller of line 3 or $14,100 x .079) | $_____ | + | $_____ | = | $_____ |
| 11. Total Tax (line 9 & 10) | $_____ | + | $_____ | = | $_____ |
| 12. Less Credits (Investment Credit, gas tax, etc.) | $_____ | + | $_____ | = | $_____ |
| 13. Estimated Tax Due (line 11-12) | $_____ | + | $_____ | = | $_____ |

*16% of item 6; but not more than $2,000 if married filing joint, $2,300 if single or unmarried head of household, and $1,300 if married filing separate; plus total of exemptions times $750 equal $_____.

UNIT III - BUSINESS MANAGEMENT

Page 2[1]

DETAILS OF RECEIPTS AND EXPENSES TO DATE (Transfer to Page One)

RECEIPTS TO DATE

1. Crop Sales:
   - a. Corn (F27-L) $_____
   - b. Soybeans (F27-L) $_____
   - c. Wheat (F27-L) $_____
   - d. Hay (F27-L) $_____
   - e. Other (F27-L) $_____
   - f. Total of a through e $_____
2. Government Payments, Custom Work, Refunds, Cash Rent (F27-L5 to 8) $_____
3. Sale of non-breeding cattle, hogs, sheep, etc. (F27-L9 to 11) $_____
4. Sale of raised poultry, eggs, dairy products (F27-L12 & 13) $_____
5. Purchase cost of market livestock sold this year $_____
6. Gross farm profit (L1f + 2 + 3 + 4 - 5) $_____

   Transfer to page 1, line 1.

EXPENSES TO DATE[2]

| | | | | | |
|---|---|---|---|---|---|
| 1. | Feed (F27-L20 | $_____ | 12. | Labor (F27-L31) | $_____ |
| 2. | Vet, Med. (F27-L21) | $_____ | 13. | Insurance (F27-L32) | $_____ |
| 3. | Breeding (F27-L22) | $_____ | 14. | Taxes (F27-L33) | $_____ |
| 4. | Fertilizer (F27-L23) | $_____ | 15. | Utilities (F27-L34) | $_____ |
| 5. | Chemicals (F27-L24) | $_____ | 16. | Truck (F27-L35) | $_____ |
| 6. | Seed (F27-L25 | $_____ | 17. | Auto (F27-L36) | $_____ |
| 7. | Mac. Rep. (F27-L26) | $_____ | 18. | Misc (F27-L37) | $_____ |
| 8. | Bldg. Rep. (F27-L27) | $_____ | 19. | Interest (F27-L38) | $_____ |
| 9. | Mach. Hire (F27-L28) | $_____ | 20. | Other | |
| 10. | Rent (F27-L29) | $_____ | | a. Pension | $_____ |
| 11. | Fuel (F27-L30) | $_____ | | b. Consv or Land Clearing | $_____ |

21. Depreciation (last year's total plus new depreciation minus expired) (F13, 15, 18) $_____
22. Total Farm Expenses (line 1 through 22) $_____

[1]All form and line numbers refer to Young Farmer Record Book.

[2]Farm Share only.

# ACRS INFORMATION

## ELECTION TO EXPENSE

| TAXABLE YEAR BEGINNING IN | MAXIMUM AMOUNT EXPENSED |
|---|---|
| 1981 | $ 0 |
| 1982 | 5,000 |
| 1983 | 5,000 |
| 1984 | 7,500 |
| 1985 | 7,500 |
| 1986 OR LATER | 10,000 |

# ACCELERATED COST RECOVERY SYSTEM

## CLASSES OF PROPERTY

3 YEAR PROPERTY - CARS, LIGHT TRUCKS (GVW OF TRUCK <13,000#), SWINE

5 YEAR PROPERTY - MACHINERY, EQUIPMENT, CATTLE, SHEEP, SINGLE PURPOSE LIVESTOCK BUILDINGS, GRAIN BINS, FENCES

10 YEAR PROPERTY - MOBILE HOME (FOR TENANTS, RENTALS)

15 YEAR PROPERTY - OTHER DEPRECIABLE REAL ESTATE

## ACCELERATED COST RECOVERY METHOD

### FOR PROPERTY PLACED IN SERVICE, 1981-84

| If the recovery year is: | The applicable percentage for the class of property is: | | |
|---|---|---|---|
| | 3-year | 5-year | 10-year |
| 1 | 25 | 15 | 8 |
| 2 | 38 | 22 | 14 |
| 3 | 37 | 21 | 12 |
| 4 | | 21 | 10 |
| 5 | | 21 | 10 |
| 6 | | | 10 |
| 7 | | | 9 |
| 8 | | | 9 |
| 9 | | | 9 |
| 10 | | | 9 |

ACRS Cost Recovery Tables for Real Estate

(15 year property)

(Except Low-Income Housing)

The applicable percentage is:
(Use the Column for the Month in the First Year
the Property is Placed in Service)

| Recovery Year | Month 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 12 | 11 | 10 | 9 | 8 | 7 | 6 | 5 | 4 | 3 | 2 | 1 |
| 2 | 10 | 10 | 11 | 11 | 11 | 11 | 11 | 11 | 11 | 11 | 11 | 12 |
| 3 | 9 | 9 | 9 | 9 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 |
| 4 | 8 | 8 | 8 | 8 | 8 | 8 | 9 | 9 | 9 | 9 | 9 | 9 |
| 5 | 7 | 7 | 7 | 7 | 7 | 7 | 8 | 8 | 8 | 8 | 8 | 8 |
| 6 | 6 | 6 | 6 | 6 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 |
| 7 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 |
| 8 | 6 | 6 | 6 | 6 | 6 | 6 | 5 | 6 | 6 | 6 | 6 | 6 |
| 9 | 6 | 6 | 6 | 6 | 5 | 6 | 5 | 5 | 5 | 6 | 6 | 6 |
| 10 | 5 | 6 | 5 | 6 | 5 | 5 | 5 | 5 | 5 | 5 | 6 | 5 |
| 11 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 12 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 13 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 14 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 15 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 16 | | | 1 | 1 | 2 | 2 | 3 | 3 | 4 | 4 | 4 | 5 |

(Note: This table does not apply for short taxable years of less than 12 months.)

## STRAIGHT LINE COST RECOVERY METHOD

| PROPERTY CLASS | OPTIONAL RECOVERY PERIODS |
|---|---|
| 3 YEAR | 3, 5, 12 YEARS |
| 5 YEAR | 5, 12, 25 YEARS |
| 10 YEAR | 15, 35, 45 YEARS |
| 15 YEAR | 15, 35,45 YEARS |

SALVAGE VALUE IS ALWAYS ZERO.

COST BASIS = CASH + BOOK VALUE OF TRADE-IN MINUS EXPENSING.

FOR 3, 5, OR 10 YEAR PROPERTY, TAKE ½ YEAR RECOVERY FIRST YEAR.

FOR 15 YEAR PROPERTY, PRO-RATE FIRST YEAR RECOVERY BY MONTH OF PURCHASE.

UNIT III - BUSINESS MANAGEMENT

EXAM

1. Bill Jones traded his old tractor on April 1 with an adjusted basis (book value) of $2,000. He paid $7,000 cash difference for a new tractor. The tractor falls into the 5-year classification of property, and he does not want the basis for regular cost recovery to be changed so he will use the 8% rate. The amount of I.C. he will receive will be:

   a. $720
   b. $600
   c. $700
   d. none of the above

2. A farmer bought a new tractor on January 2, for $8,000. What is the maximum depreciation which he can take the first year of ownership? Use the accelerated method.

   a. $1,450
   b. $1,680
   c. $1,200
   d. $2,000

3. A farmer faced unusually high federal income taxes in 1983. To reduce the tax, he purchased a new tractor for $15,000 cash in September, 1983, and did not have a trade-in. For 1983, he can:

   a. take regular depreciation/cost recovery for the year
   b. expense $5,000
   c. take advantage of investment credit
   d. do a, b, and c

4. Compute the investment credit (10%) for a farmer who made the following purhcases:

   a. purchased a new $21,000 combine with no trade-in
   b. traded a used tractor with an adjusted basis of $5,000 and in addition gave $5,000 boot for a new one
   c. purhcased a used baler for $500 cash and traded in an old baler with an adjusted basis of $300.

5. Match the following expense items:

a. deductible in year paid
b. deductible at later date
c. deductible through depreciation
d. deductible through alternative methods
e. deductible when farm is sold
f. non-deductible expense

____ 1) $3,000 paid for hog feed

____ 2) $80,000 paid for a farm

____ 3) $12.50 paid for gasoline for personal auto

____ 4) $2,500 paid for feeder pigs

____ 5) $10,000 paid for new tractor

____ 6) $1,800 paid for clearing timber with bulldozer

6. Match the following income items:

a. farm business income
b. sale of capital items
c. non-farm income

____ 1) $8,000 received from sale of raised market hogs

____ 2) $2,000 received from doing customer baling

____ 3) $150 received for carpentry work done for neighbor

____ 4) $1,000 received from sale of raised sows (2 years old)

____ 5) $1,500 received from sale of beef cows bought last week

____ 6) $500 received from sale of used plow that is depreciated out

7. What is the "basis" for the following transactions:

a. traded in a tractor with basis of $2,000; gave $8,000 to boot on a new tractor? _____

b. purchased a new combine for $20,000 on January 2. Expensed $2,000; 10% investment credit; use accelerated cost recovery method. Basis at end of year? _____

8. Compute the cost recovery for $1,000 worth of breeding swine (3-year property). No expensing.

| Year | Accelerated | Straight Line |
|---|---|---|
| a. 1 | _____ | _____ |
| b. 2 | _____ | _____ |
| c. 3 | _____ | _____ |
| d. 4 | _____ | _____ |
| e. 5 | _____ | _____ |

9. Good records are essential for tax management. True or False

10. The goal of good tax management is to _____.

UNIT III - BUSINESS MANAGEMENT

ANSWERS TO EXAM

1. b (2000 + 7000 x .08 = $720)

2. b (8000 x .15 = $1,200)

3. d

4. a. $2100
   b. 1000
   c. 50
   d. 3150 (Total)

5. 1) a
   2) e
   3) f
   4) b
   5) c
   6) d

6. 1) a
   2) a
   3) c
   4) b
   5) a
   6) b

7. a. $10,000
   b. $14,535 [$20,000 - $2,000 (expensing) = $18,000 x 10% I.C. rate = $1,800 I.C. ÷ 2 = $900. $18,00 - $900 = $17,100 (basis for regular cost recovery) x .15 = $2,565 cost recovered 1st year. $17,100 - $2,565 = $14,535 basis at end of year.]

8.

| | Accelerated | Straight Line |
|---|---|---|
| a. | 250 | 166.67 |
| b. | 380 | 333.33 |
| c. | 370 | 333.33 |
| d. | -0- | 166.67 |

9. True

10. maximize after-tax income

UNIT - STARTING TO FARM

Lesson 3 - How can I use depreciation/cost recovery and investment credit in my farm business?

Objective: At the end of the lesson, the student will: (1) recognize and be able to figure depreciation/cost recovery and investment credit in order to take advantage of deductions and credits in income tax reporting and (2) develop an acceptable, defensible record system for depreciable property.

Study Questions:

1. List the reasons farmers need to be able to use depreciation/cost recovery records.

2. Discuss the advantages of (1) accelerated cost recovery and (2) straight line depreciation.

3. Write the formula for computing the accelerated and the alternate straight line methods of depreciation/cost recovery.

4. List the characteristics of expensing.

5. Define investment credit and list the characteristics and IRS rules pertaining to investment credit.

Reference:

1. Farmers Tax Guide

2. Handouts

UNIT - STARTING TO FARM

TEACHING PROCEDURE

A. Review Lesson 2 of Unit II - Expanding the SOE Program.

B. Motivation: What is investment credit? What choices do I have on depreciation?

C. Assignment

D. Supervised Study

E. Discussion:

1. Review with the students the reason for using depreciation/cost recovery. List on the board the reasons we use depreciation records.

   a. List the reasons farmers need to be able to use depreciation/cost recovery records.

      1) In general, IRS won't allow deduction of the total cost of a capital asset in the year purchased if it has a life of more than one year and special provisions for expensing are not used.
      2) Farmers want to deduct part of the cost of a large capital purchase over a period of years.
      3) Depreciation/cost recovery is used in analysis of a farm business.

2. Explain to the students that the two systems of figuring depreciation are the accelerated method and the straight line method.

   a. Discuss the advantages of (1) accelerated cost recovery and (2) straight line depreciation.

      1) Advantages of the accelerated cost recovery method
         a) If a farmer is keeping his money reinvested, he will want to get the tax deduction as soon as possible. ($1.00 today is worth more than $1.00 one year from today.)
         b) By taking more depreciation in the early years of an investment, the farmer pays less taxes and he can then make more investments.
         c) New investments sometimes create a cash flow problem in the first few years. A quick method of depreciation will help with taxes and release more money for payments.

2) Advantages of straight line depreciation/ cost recovery
   a) Easy to compute
   b) Constant deduction each year - may help to balance income
   c) When some investments are made, they do not generate much income for a few years - you may not want much depreciation the first year.

3. Illustrate on the board the formula for computing both the accelerated and straight line methods.

   a. Write the formulas for computing the accelerated and the alternate straight line methods of depreciation/cost recovery.

      1) Accelerated Cost Recovery--
         a) Determine property class
         b) Determine basis for cost recovery
         c) Basis X percentage = cost recovered

         (NOTE: Use TM-1 & TM-2/HO-4 to get recovery percentages.)

      2) Straight Line Method--
         a) Determine property class
         b) Determine basis for cost recovery
         c) Choose recovery period
         d) Basis ÷ years (÷ 2 for 1st year on 3- and 5-year property) (1st year prorated by month for 15-year property)

         (NOTE: Use TM-2/HO-4 to get periods.)

4. Explain and list on the board the characteristics of expensing.

   a. List the characteristics of expensing.

      1) Expensing replaces additional 20% depreciation.
      2) Expensing allows quick write-off of purchases.
      3) Can only expense cash difference paid.
      4) Can only expense items that qualify for investment credit (I.C.).
      5) Can expense any or all of an item or combination of items up to the maximum.
      6) I.C. is lost on amount expensed.
      7) Use to write off small items.
      8) Use when in very high tax bracket.

5. Discuss with students the definition of investment credit and list on the board the main characteristics and rules pertaining to investment credit.

a. Define investment credit and list the characteristics and IRS rules pertaining to investment credit.

1) A direct tax credit - offsets tax dollar for dollar.
2) Must be taken on 3- and 5-year property.
3) Can be taken on new and used property.
4) When computing recovery basis on trade-ins, include remaining record book value of trade-in when trading for new equipment, but not used.
5) Is recaptured for early disposition, 20% per year for 5-year property, and 33% per year for 3-year property.
6) Can be carried back 3 years and forward up to 15 years.
7) On 5-year property, use 10% of qualified basis and reduce basis for cost recovery by ½ the I.C. taken--or--use 8%, and the basis for cost recovery remains the same.
8) On 3-year property, use 6% of qualified basis and reduce the basis for cost recovery by ½ the I.C. taken--or--use 4%, and basis for cost recovery remains the same.

F. Other Activities

a. Determine the depreciation/cost recovery and investment credit, and record your answer in the young farmer record book for the following problem:

A farmer bought a new tractor on July 1. He traded in an old tractor with a book value of $3,000 and paid $16,000 in cash. Find investment credit and regular depreciation/cost recovery for first year using the accelerated cost recovery method. (NOTE: Keep basis for regular depreciation at the maximum amount.)

Show transparency of Form 12/13.

Answer: Basis for cost recovery = $16,000 + $3,000 = $19,000.
$19,000 x 8% (I.C. rate) = $1520 investment credit
$19,000 x 15% (1st year cost recovery rate) = $2850 1st year cost recovery.

b. Determine the depreciation/cost recovery and investment credit and record your answer in the young farmer record book for the following problem:

A farmer bought 10 sows on January 2 for $300 cash. Find investment credit and straight line depreciation/cost recovery. (NOTE: Get maximum I.C. possible.)

Answer: $300 x 10 = $3000 basis for investment credit.
$3000 x 6% (I.C. Rate) = $180.00 investment credit.
$3000 - $90 ($\frac{1}{2}$ I.C. Rate claimed) = $2910 basis for regular cost recovery.
$2910 x 25% (1st year cost recovery rate) = $728
$728 ÷ 2 = $364 cost recovered the 1st year.

G. Competencies

1. To list the advantages of using either the straight line or accelerated cost recovery method, and be able to compute the amount recovered for a given item under either method.

2. To describe the characteristics of expensing and investment credit, and to use both to achieve the maximum tax advantage.

H. Exam and/or Evaluation

## ACCELERATED COST RECOVERY METHOD

FOR PROPERTY PLACED IN SERVICE, AFTER 1980

| IF THE RECOVERY YEAR IS: | THE APPLICABLE PERCENTAGE FOR THE CLASS OF PROPERTY IS: 3-YEAR | 5-YEAR | 10-YEAR |
|---|---|---|---|
| 1 | 25 | 15 | 8 |
| 2 | 38 | 22 | 14 |
| 3 | 37 | 21 | 12 |
| 4 | | 21 | 10 |
| 5 | | 21 | 10 |
| 6 | | | 10 |
| 7 | | | 9 |
| 8 | | | 9 |
| 9 | | | 9 |
| 10 | | | 9 |

ACRS Cost Recovery Tables for Real Estate

(15 year property)

(Except Low-Income Housing)

The applicable percentage is:
(Use the Column for the Month in the First Year
the Property is Placed in Service)

| Recovery Year | Month 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 12 | 11 | 10 | 9 | 8 | 7 | 6 | 5 | 4 | 3 | 2 | 1 |
| 2 | 10 | 10 | 11 | 11 | 11 | 11 | 11 | 11 | 11 | 11 | 11 | 12 |
| 3 | 9 | 9 | 9 | 9 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 |
| 4 | 8 | 8 | 8 | 8 | 8 | 8 | 9 | 9 | 9 | 9 | 9 | 9 |
| 5 | 7 | 7 | 7 | 7 | 7 | 7 | 8 | 8 | 8 | 8 | 8 | 8 |
| 6 | 6 | 6 | 6 | 6 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 |
| 7 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 |
| 8 | 6 | 6 | 6 | 6 | 6 | 6 | 5 | 6 | 6 | 6 | 6 | 6 |
| 9 | 6 | 6 | 6 | 6 | 5 | 6 | 5 | 5 | 5 | 6 | 6 | 6 |
| 10 | 5 | 6 | 5 | 6 | 5 | 5 | 5 | 5 | 5 | 5 | 6 | 5 |
| 11 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 12 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 13 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 14 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 15 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| 16 | | | 1 | 1 | 2 | 2 | 3 | 3 | 4 | 4 | 4 | 5 |

(Note: This table does not apply for short taxable years of less than 12 months.)

## STRAIGHT LINE COST RECOVERY METHOD

| PROPERTY CLASS | OPTIONAL RECOVERY PERIODS |
|---|---|
| 3 YEAR | 3, 5, 12 YEARS |
| 5 YEAR | 5, 12, 25 YEARS |
| 10 YEAR | 15, 35, 45 YEARS |
| 15 YEAR | 15, 35,45 YEARS |

SALVAGE VALUE IS ALWAYS ZERO.

COST BASIS = CASH + BOOK VALUE OF TRADE-IN MINUS EXPENSING.

FOR 3, 5, OR 10 YEAR PROPERTY, TAKE ½ YEAR RECOVERY FIRST YEAR.

FOR 15 YEAR PROPERTY, PRO-RATE FIRST YEAR RECOVERY BY MONTH OF PURCHASE.

AFTER 1982, THE COST BASIS WILL BE REDUCED BY 1/2 OF THE INVESTMENT CREDIT TAKEN UNLESS THE TAXPAYER OPTS FOR A REDUCED INVESTMENT CREDIT. (REDUCED BY 2%)

UNIT - EXPANDING THE SOE PROGRAM

Lesson 2 - How do I set up depreciation/cost recovery schedules and inventories?

Objective: To describe why depreciation and inventories are important to record keeping, and to correctly record depreciation and inventories in the Missouri Young Farmer Record Book.

Study Questions:

1. What is depreciation/cost recovery?
2. Explain the criteria that you must use in determining if an item can be depreciated.
3. List examples of items on a farm that are depreciated.
4. What steps are involved in deciding the amount of depreciation/cost recovery?
5. How do I determine the correct property class for an asset?
6. What are the methods of figuring depreciation under the Acclerated Cost Recovery System?
7. What is an inventory, and why is it important for a farmer to use the inventory to determine actual net profit?

Reference:

1. Handout
2. SOE Student Reference II

UNIT - EXPANDING THE SOE PROGRAM

TEACHING PROCEDURE

A. Review

B. Motivation: Ask the class if the total cost of a breeding animal, equipment, and machinery should all be deducted from the farming program as an expense in the year purchased.

C. Assignment

D. Supervised Study

E. Discussion

1. List on the board definitions of depreciation as given to you by the class. Ask the students why certain items depreciate.

   a. What is depreciation/cost recovery?

      1) Depreciation is a reduction in value due to wear, exhaustion, tear, and obsolescence. It is the amount of purchase cost that can be deducted from taxes (recovered) in a given year.

2. Ask the students if they can determine if a purchase should be depreciated. List on the board the factors to consider in determining if depreciation is allowed.

   a. Explain the criteria that you must use in determining if an item can be depreciated.

      1) Must have a life of more than one year
      2) Must have a limited and determinable life
      3) Must be used in the farm business
      4) Must be purchased (can't depreciate raised animals)

      (NOTE: Tell the students that a farmer should set an amount, such as $50.00, in deciding whether to depreciate or charge off as an expense.)

3. Ask each student to submit items which they own that are depreciating, and list these items on the board.

   a. List examples of items on a farm that are depreciated.

      1) Purchased breeding livestock
      2) Machinery
      3) Livestock equipment

4) Buildings
5) Fences
6) Pickups and cars (if used in farm business)

4. List the steps involved in deciding the amount of depreciation. Discuss each step as it is listed.

   a. What steps are involved in deciding the amount depreciation/cost recovery?

      1) Determine property class
      2) Determine basis for cost recovery
      3) Determine method of cost recovery to use
      4) Determine amount to be recovered each year

5. List property classes on board, and begin to develop a list of assets under each heading.

   a. How do I determine the correct property class for an asset?

      1) 3-year property - cars, trucks, breeding swine
      2) 5-year property - machinery, equipment, breeding cattle, single purpose livestock buildings, grain bins, fences, etc.
      3) 10-year property - mobile homes (rentals for tenants)
      4) 15-year property - other depreciable real estate

      (NOTE: Students should commit this list to memory.)

6. Start the discussion by listing on the board the methods of figuring depreciation/cost recovery.

   a. What are the methods of figuring depreciation under the Accelerated Cost Recovery System?

      1) Accelerated
         (Basis x % eligible for depreciation each year)
      2) Alternate Straight Line
         Depreciation = $\frac{\text{Basis}}{\text{Recovery Period/yrs.}}$

      Note: If using alternate straight line on 3- and 5-year property, the amount recovered is divided by 2 for the first year. On 15-year property, the first year recovery is prorated by month of purchase.

   Other: Give students a sample straight line problem such as: Purchased a tractor for $5,000.

   $\frac{\$5,000}{5}$ = $1,000 ÷ 2 = $500 1st year depreciation

Have the students turn to the depreciation section in the Young Farmer Record Book and give them a sample problem to record in the book.

Problem A: You purchased a sheep feeder for $120 on February 26. Use accelerated method.

120 x 15% = $18 the first year

Problem B: You have a sheep shelter for which you paid $360. Use straight line method and a 5-year recovery period. What class of property is it? What is the depreciation taken in year 3?

1) 360 x 21% = $76 2) 5 year

Show the students the transparency of Form 12/13.

Have the students list all of their equipment and livestock that should be depreciated and record it in their record books. Give the students time to complete this assignment.

7. Begin this discussion by asking if a vocational agriculture student could make a profit if they sold $1,500 worth of hogs during the year and purchased $2,500 worth of items. Can you tell? What would happen if the inventory increased $1,200?

   a. What is an inventory, and why is it important for a farmer to use the inventory to determine actual net profit?

      1) An inventory is a list of livestock, machinery, stored crops, and supplies and their values on a particular date.
      2) Inventories are necessary to determine actual net profit or loss.
      3) A farmer cannot properly analyze his or her business growth without an inventory each year.

   Have the students correct their inventories after they complete their depreciation records. (Have them use the next column and use the current date.)

F. Other Activities

Students can use the Sample Entries from Unit I to record closing inventories and depreciation as a practice activity. These items are recorded on TM-1, TM-2, and TM-3.

G. Competencies

1. Students will discuss the importance of depreciation/ cost recovery and inventories in record keeping.

2. Students will correctly calculate and record depreciation/cost recovery and inventories in the Missouri Young Farmer Book.

H. Exam and/or Evaluation - You should check the students' record books for accuracy and completeness.

FORM 12 PAGE DEPRECIATION SCHEDULE: _____ MACHINERY AND EQUIPMENT

| LINE | DATE ACQUIRED | ITEM DESCRIPTION KIND OF MACHINE, MAKE, MODEL, SIZE | ID. NO. | NEW OR USED | INVEST. CREDIT | COST INFORMATION REM'NG BOOK VALUE OF TRADE-IN | COST INFORMATION CASH DIFF. PAID | COST INFORMATION TOTAL COST BASIS | ADDITI. FIRST YEAR DEPREC. | SALVAGE VALUE | DEPRECIATION INFORMATION BALANCE FOR REGULAR DEPREC. | DEPRECIATION INFORMATION LIFE | DEPRECIATION INFORMATION METHOD | DEPRECIATION INFORMATION ANNUAL DEPREC % or $ | DEPRECIATION INFORMATION DEPREC. TAKEN IN PRIOR YEARS | LINE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | | Old ADR method | | | | | | | | | | | | | | 1 |
| 2 | 1976 | Portable Shop Shelter | | N | | | 300 | 300 | | -0- | 300 | 10 | S | 30 | -0- | 2 |
| 3 | 1977 | Shop Feeder | | U | 12 | | 120 | 120 | | -0- | 120 | 10 | S | 12 | -0- | 3 |
| 4 | | | | | | | | | | | | | | | | 4 |
| 5 | | | | | | | | | | | | | | | | 5 |
| 6 | | New ACRS Method | | | | | | | | | | | | | | 6 |
| 7 | 1983 | Portable Shop Shelter | | N | | | 300 | 300 | | | 300 | 5 | S | 60 | -0- | 7 |
| 8 | 1983 | Shop Feeder | | U | | | 120 | 120 | | | 120 | 5 | A | - | -0- | 8 |
| 9 | | | | | | | | | | | | | | | | 9 |
| 10 | | | | | | | | | | | | | | | | 10 |
| 11 | | | | | | | | | | | | | | | | 11 |
| 12 | | | | | | | | | | | | | | | | 12 |
| 13 | | | | | | | | | | | | | | | | 13 |
| 14 | | | | | | | | | | | | | | | | 14 |
| 15 | | | | | | | | | | | | | | | | 15 |
| 16 | | | | | | | | | | | | | | | | 16 |
| 17 | | | | | | | | | | | | | | | | 17 |
| 18 | | | | | | | | | | | | | | | | 18 |
| 19 | | | | | | | | | | | | | | | | 19 |
| 20 | | | | | | | | | | | | | | | | 20 |
| 21 | | | | | | | | | | | | | | | | 23 |
| 22 | | | | | | | | | | | | | | | | 22 |
| 23 | | | | | | | | | | | | | | | | 23 |
| 24 | | | | | | | | | | | | | | | | 24 |
| 25 | | | | | | | | | | | | | | | | 25 |
| | 96 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15A | |

TM - 1

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FORM 13 PAGE DEPRECIATION SCHEDULE: _____ MACHINERY AND EQUIPMENT (CONT.)

| LINE | | END 1976 | | END 1977 | | END 1983 | | END 1984 | | ESTIMATED CURRENT CASH VALUE | | | | | LINE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | REM'NG BK. VAL. AT START OF YEAR | DEPREC THIS YEAR | REM'NG BOOK VALUE | DEPREC. THIS YEAR | REM'NG BOOK VALUE | DEPREC. THIS YEAR | REM'NG BOOK VALUE | DEPREC. THIS YEAR | REM'NG BOOK VALUE | START 19__ | END 19__ | END 19__ | END 19__ | END 19__ | |
| 1 | | -0- | 300 | 30 | 270 | | | | | | | | | | 1 |
| 2 | | | | -0- | 120 | | | | | | | | | | 2 |
| 3 | | | | | | 30 | 270 | 60 | 210 | | | | | | 3 |
| 4 | | | | | | 18 | 102 | 25 | 77 | | | | | | 4 |
| 5 | | | | | | | | | | | | | | | 5 |
| 6 | | | | | | | | | | | | | | | 6 |
| 7 | | | | | | | | | | | | | | | 7 |
| 8 | | | | | | | | | | | | | | | 8 |
| 9 | | | | | | | | | | | | | | | 9 |
| 10 | | | | | | | | | | | | | | | 10 |
| 11 | | | | | | | | | | | | | | | 11 |
| 12 | | | | | | | | | | | | | | | 12 |
| 13 | | | | | | | | | | | | | | | 13 |
| 14 | | | | | | | | | | | | | | | 14 |
| 15 | | | | | | | | | | | | | | | 15 |
| 16 | | | | | | | | | | | | | | | 16 |
| 17 | | | | | | | | | | | | | | | 17 |
| 18 | | | | | | | | | | | | | | | 18 |
| 19 | | | | | | | | | | | | | | | 19 |
| 20 | | | | | | | | | | | | | | | 20 |
| 21 | | | | | | | | | | | | | | | 21 |
| 22 | | | | | | | | | | | | | | | 22 |
| 23 | | | | | | | | | | | | | | | 23 |
| 24 | | | | | | | | | | | | | | | 24 |
| 25 | | | | | | | | | | | | | | | 25 |
| | 16A | 15B | 16B | 15C | 16C | 15D | 16D | 15E | 16E | 17A | 17B | 17C | 17D | 17E | |

TM-2

II-13

## FORM 16

## INVENTORY OF LIVESTOCK

| LINE | | START 19 7 7 | | | | END 19 7 7 | | | | END 19__ | | | | END 19__ | | | | END 19__ | | | | LINE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | NO. HEAD | TOTAL WT. | PRICE PER UNIT | TOTAL VALUE | NO. HEAD | TOTAL WT. | PRICE PER UNIT | TOTAL VALUE | NO. HEAD | TOTAL WT. | PRICE PER UNIT | TOTAL VALUE | NO. HEAD | TOTAL WT | PRICE PER UNIT | TOTAL VALUE | NO. HEAD | TOTAL WT. | PRICE PER UNIT | TOTAL VALUE | |
| | SWINE | | | | | | | | | | | | | | | | | | | | | |
| 1 | Purch. Breeding F. 14/15 | | | | | | | | | | | | | | | | | | | | | 1 |
| 2 | Rsd. Breeding · Sows | | | | | | | | | | | | | | | | | | | | | 2 |
| 3 | · Gilts | | | | | | | | | | | | | | | | | | | | | 3 |
| 4 | · Boars | | | | | | | | | | | | | | | | | | | | | 4 |
| 5 | TOTAL BREEDING SWINE | | | | | | | | | | | | | | | | | | | | | 5 |
| 6 | Hogs | | | | | | | | | | | | | | | | | | | | | 6 |
| 7 | Pigs | | | | | | | | | | | | | | | | | | | | | 7 |
| 8 | Gilts | | | | | | | | | | | | | | | | | | | | | 8 |
| 9 | Boars | | | | | | | | | | | | | | | | | | | | | 9 |
| 10 | TOT. NON-BREED. SWINE | | | | | | | | | | | | | | | | | | | | | 10 |
| 11 | TOTAL SWINE | | | | | | | | | | | | | | | | | | | | | 11 |
| | BEEF | | | | | | | | | | | | | | | | | | | | | |
| 12 | Purch. Breeding F. 14/15 | | | | | | | | | | | | | | | | | | | | | 12 |
| 13 | Rsd. Breeding · Cows | 7 | 6300 | 225 | 1575 | 7 | 6300 | 225 | 1575 | | | | | | | | | | | | | 13 |
| 14 | · Heifers | | | | | | | | | | | | | | | | | | | | | 14 |
| 15 | · Bulls | | | | | | | | | | | | | | | | | | | | | 15 |
| 16 | TOTAL BREEDING BEEF | | | | 1575 | | | | 1575 | | | | | | | | | | | | | 16 |
| 17 | 1-2 years Heifers | | | | | | | | | | | | | | | | | | | | | 17 |
| 18 | Bulls | | | | | | | | | | | | | | | | | | | | | 18 |
| 19 | weaned, Heifers | | | | | | | | | | | | | | | | | | | | | 19 |
| 20 | Bulls | | | | | | | | | | | | | | | | | | | | | 20 |
| 21 | Steers | | | | | | | | | | | | | | | | | | | | | 21 |
| 22 | Sucking Calves | 6 | 2100 | 167 | 1000 | 7 | 2450 | | 1050 | | | | | | | | | | | | | 22 |
| 23 | TOTAL NON-BREED. BEEF | | | | 1000 | | | | 1050 | | | | | | | | | | | | | 23 |
| 24 | TOTAL BEEF | 13 | 8400 | | 2575 | 14 | 8750 | | 2625 | | | | | | | | | | | | | 24 |
| | DAIRY | | | | | | | | | | | | | | | | | | | | | |
| 25 | Purch. Breeding F. 14/15 | | | | | | | | | | | | | | | | | | | | | 25 |
| 26 | Rsd. Breeding · Cows | | | | | | | | | | | | | | | | | | | | | 26 |
| 27 | Bred Heifers | | | | | | | | | | | | | | | | | | | | | 27 |
| 28 | Open Heifers | | | | | | | | | | | | | | | | | | | | | 28 |
| 29 | Bulls | | | | | | | | | | | | | | | | | | | | | 29 |
| 30 | TOTAL BREEDING DAIRY | | | | | | | | | | | | | | | | | | | | | 30 |
| 31 | Heifers | | | | | | | | | | | | | | | | | | | | | 31 |
| 32 | Bulls | | | | | | | | | | | | | | | | | | | | | 32 |
| 33 | Steers | | | | | | | | | | | | | | | | | | | | | 33 |
| 34 | Calves | | | | | | | | | | | | | | | | | | | | | 34 |
| 35 | TOT. NON-BREED. DAIRY | | | | | | | | | | | | | | | | | | | | | 35 |
| 36 | TOTAL DAIRY | | | | | | | | | | | | | | | | | | | | | 36 |
| | OTHER SHEEP | | | | | | | | | | | | | | | | | | | | | |
| 37 | EWES | 22 | 5500 | 60 | 1320 | 22 | 5500 | 57 | 1260 | | | | | | | | | | | | | 37 |
| 38 | RAM | 1 | 300 | 150 | 150 | 1 | 300 | 150 | 150 | | | | | | | | | | | | | 38 |
| 39 | TOT. BREEDING | | | | 1470 | | | | 1410 | | | | | | | | | | | | | 39 |
| 40 | LAMBS | | | | | | | | | | | | | | | | | | | | | 40 |
| 41 | | | | | | | | | | | | | | | | | | | | | | 41 |
| 42 | TOT. NON-BREEDING | | | | | | | | | | | | | | | | | | | | | 42 |
| 43 | TOTAL SHEEP | | | | 1470 | | | | 1910 | | | | | | | | | | | | | 43 |
| 44 | FORM TOTAL | | | | 4045 | | | | 4535 | | | | | | | | | | | | | 44 |
| 45 | TOTAL RAISED BREEDING | | | | | | | | | | | | | | | | | | | | | 45 |

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II-15

# RECORD BOOK EVALUATION FORM

| MONTHLY RECORD | POINTS |
|---|---|
| 1. Receipts Form--2, 3, 4, & 5--completed and totaled | 5 |
| 2. Expense Form--7, 8, 9, & 10--completed and totaled | 5 |
| 3. Cash Flow Summary Form--27 | 10 |
| TOTAL A_____B_____C_____D_____ | |
| E_____F_____G_____H_____ | |
| I_____J_____K_____ | |
| Good Management Practices Form--55--completed | 5 |
| TOTAL | 25 |
| May-September--evaluation items, 1, 2, 3 above plus the following: | 25 |
| Machinery and Equipment inventory update Form--12 & 13 | 5 |
| Breeding Livestock update Form--14 & 15 | 5 |
| Money Borrowed record Form--21 or 22 | 2 |
| Breeding and Performance Record Form--57 | 5 |
| FFA Leadership and Participation Form--81 & 82 | 5 |
| Proficiency Award Information | 3 |
| TOTAL | 25 |
| December-January Evaluation--all items above plus the following: | 50 |
| Inventory of Livestock Form--16 | 5 |
| Inventory Feed-Crops, etc. Form--17 | 5 |
| Completed Form--27 | 5 |
| Financial Statement Form--28 | 5 |
| Profit and Loss Statement Form--29 | 5 |
| SOE Planned and completed Form--52 | 5 |
| Business Agreement Form--54 | 5 |
| Enterprise Analysis Form--59 & 60 | 5 |
| Summary Form--61 | 5 |
| For the coming year Form--27 | 5 |
| TOTAL | 50 |

RECORDS TOTAL 100 points